Journal of Law and Policy

Volume 20
Issue 2
SYMPOSIUM: Meaningful Reciprocity - In Honor of Clare Dalton

Article 14

2012

Protecting Tenants at Foreclosure By Funding Needed Repairs

Steven T. Hasty

PROTECTING TENANTS AT FORECLOSURE BY FUNDING NEEDED REPAIRS

*Steven T. Hasty**

I. INTRODUCTION

In 2008, the investment group Milbank Real Estate Services effectively abandoned[1] ten apartment towers it owned in the Bronx and defaulted on its $35 million mortgage loan.[2] By all accounts, the buildings were in serious disrepair: the roofs leaked, rats and roaches infested the apartments, and several units were fire-damaged.[3] Some of the 548 units were uninhabitable and vacant, but most had tenants living in them.[4] After Milbank stopped paying the mortgage, the mortgagee (a

---

* J.D. Candidate, Brooklyn Law School, 2013; B.A., New York University, 2007. Many thanks to Ian Davie of Legal Services N.Y.C.–Bronx and Shira Galinsky of South Brooklyn Legal Services for providing helpful background, to Professor Jessica Attie for her insightful comments, and to the editorial staff of the *Journal of Law and Policy* for their input and suggestions.

[1] *See generally Hearing on Intros. 494, 500, & 501 Before the Comm. on Hous. & Bldgs. of the N.Y.C. Council*, 2011 Leg., 2011 Sess. 164–65 (N.Y. Apr. 14, 2011) [hereinafter *Hearings*] (testimony of Elizabeth M. Lynch, MFY Legal Servs.) ("It is a fact that some owners abandon their property once a foreclosure action is commenced. . . . [But] homeowners . . . in one- to four-family houses, rarely abandon their homes.").

[2] Tenant-Defendants Memorandum of Law at 1–5, *Milbank*, No. 380454/09 (N.Y. Sup. Ct. Bronx Cnty. Mar. 17, 2009) [hereinafter Milbank Tenants' Memorandum of Law].

[3] *Id.* at 3–4. There were 4,300 housing code violations on record at the time the tenants filed their motion seeking payment from the mortgagee to cover repairs; 756 were classified as "immediately hazardous." *Id.* at 3; Transcript of Oral Argument at 11–12, *Milbank*, No. 380454/09 [hereinafter Milbank Transcript].

[4] Milbank Transcript, *supra* note 3, at 11–12.

mortgage-backed securities trust)[5] began a foreclosure action and asked the court to appoint a receiver to take control of the properties.[6] Although the securities trust had advanced some funds for taxes and water bills, the court-appointed receiver had only a very modest rental income from the properties and could not afford to make repairs.[7] As the foreclosure case dragged on, some of the tenants began to withhold rent because of poor housing conditions.[8]

In April 2010, the tenants moved the foreclosure court for an order compelling the plaintiff mortgagee to provide enough funds to enable the receiver to make repairs.[9] The tenants estimated that it would cost $17–25 million to rehabilitate the buildings,[10] but the defendant Milbank was unwilling (or unable) to pay for even emergency repairs.[11] Relying on ten-year-old

---

[5] The parties are described in detail *infra* at notes 157–62 and in the accompanying text.

[6] Milbank Tenants' Memorandum of Law, *supra* note 2, at 4–5. Receivership is discussed in greater detail below in Part II.

[7] Milbank Transcript, *supra* note 3, at 12, 18.

[8] *Id*. at 12; Amended Affidavit of Cicciu at para. 12, *Milbank*, No. 380454/09 (N.Y. Sup. Ct. Bronx Cnty. Mar. 17, 2009) ("[M]uch of this arrearage may not be collectible because many tenants are invoking the defense of breach of the warranty of habitability.").

[9] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1. The tenants were named as "'John Doe' Nos. 1–25" in the foreclosure action. Milbank Transcript, *supra* note 3, at 16.

[10] Milbank Transcript, *supra* note 3, at 7.

[11] *See* Milbank Tenants' Memorandum of Law, *supra* note 2, at 5. Some of the entities that held title to Milbank's properties have entered bankruptcy. Dakota Smith, *Downtown's Roosevelt Lofts Files for Chapter 11 Bankruptcy*, CURBED LA (Apr. 14, 2009), http://la.curbed.com/archives/2009/04/downtowns_roosevelt_lofts_files_for_chapter_11_bankruptcy.php. According to its press release, however, "[t]here is no direct legal relationship between Roosevelt Lofts, LLC and Milbank Real Estate Services, Inc. Milbank is thus not affected by Roosevelt's Chapter 11 filing, and continues to operate its various business operations and real estate ventures without interruption or oversight by the Bankruptcy Court." *Id*. Milbank's website has remained static and unchanged since 2008, and its status is unknown. *See What's New*, MILBANK, http://www.milbankre.com/whatsnew.php (last visited May 10, 2012) (listing press releases, the newest of which is dated October 2008).

appellate court dicta[12] and employing a four-factor equitable test,[13] the court ordered the mortgagee to advance $2.5 million to the receiver during the foreclosure action to cover the cost of correcting the immediately hazardous conditions in Milbank's buildings.[14] While this outcome was an important victory for Milbank's Bronx tenants, it is unfortunately not the norm.[15] During the gap period between an owner's default and a judgment of foreclosure, tenants too often face uninhabitable conditions that go long uncorrected.[16]

Among the victims of the current mortgage foreclosure crisis, tenants of buildings in foreclosure are often innocent, harmed, and overlooked.[17] A nonresident investor-owner may

---

[12] *See* Milbank Transcript, *supra* note 3, at 10, 20 (discussing Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 589–90 (App. Div. 1997)).

[13] The court examined (1) the degree of necessity of the expenses, (2) whether a benefit would accrue to the party who requested that a receiver be appointed, (3) whether the foreclosing mortgage lender was aware that the building's income would be insufficient to pay the receiver's expenses when it asked that one be appointed, and (4) whether the funds would be judicially expended. Milbank Transcript, *supra* note 3, at 10, 12–13, 18–19.

[14] *Milbank*, No. 380454/09 (granting motion "for reasons stated on the record"); Milbank Transcript, *supra* note 3, at 20.

[15] *See, e.g.*, Wash. Mut. Bank v. Browne, No. 27151/08 (N.Y. Sup. Ct. Kings Cnty. Oct. 5, 2009) (denying a motion similar to that granted in *Milbank*, but granting tenants leave to bring a separate action in Housing Court); Union Sav. Bank v. 285 Lafayette Assocs., N.Y. L.J., May 20, 1992, at 21 (finding no remedy at law and denying an equitable remedy to tenants where deficiencies in the building predated the bank's involvement).

[16] Raun J. Rasmussen, *Foreclosure Crisis: Both Owners, Many Tenants to Be Homeless*, N.Y. L.J. (Jan. 16, 2009), http://www.newyorklawjournal.com/PubArticleNY.jsp?id=1202427485794&slreturn=1.

[17] Armin Bazikyan, *Renters: The Innocent Victims of the Foreclosure Mortgage Crisis*, 39 SW. L. REV. 339, 344 (2009) ("The plight of the renter has become a silent problem."); Vicki Been & Allegra Glashausser, *Tenants: Innocent Victims of the Nation's Foreclosure Crisis*, 2 ALB. GOV'T L. REV. 1, 3 (2009) ("[R]enters are often completely unaware that their landlords are in default until utilities are shut off or an eviction notice appears on their door."); Tony S. Guo, *Tenants at Foreclosure: Mitigating Harm to Innocent Victims of the Foreclosure Crisis*, 4 DEPAUL J. FOR SOC. JUST. 215 (2011); Danilo Pelletiere & Keith Wardrip, *Renters and the Housing Credit Crisis*, POVERTY & RACE (Poverty & Race Research Action Council, Wash., D.C.),

endure a lengthy foreclosure proceeding and suffer a serious financial setback,[18] but the resident-tenants of a property in foreclosure must literally live with the consequences[19]—from leaks and recurrent mold to broken appliances and lack of heat and hot water.[20] Although the primary threat to tenants at foreclosure is eviction by usual means,[21] they also face the threat of constructive eviction because of uninhabitable conditions.[22] The owner of a multiple dwelling in foreclosure typically has inadequate funds to make repairs required by the applicable housing code and the implied warranty of habitability (the basic guarantee that a rented residence will be livable), leaving tenants especially vulnerable.[23]

Further, a judicial foreclosure action may take years to resolve,[24] and the presence of a court-appointed receiver may

---

July/Aug. 2008, at 3, *available at* http://www.prrac.org/full_text.php?text_id=1189&item_id=11271&newsletter_id=100.

[18] Rasmussen, *supra* note 16.

[19] Memorandum of Law of Proposed Amicus Curiae, The Council of the City of New York, in Support of Tenants' Motion at 5, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Nov. 16, 2009) [hereinafter City Council Amicus Brief] ("[T]housands of tenants in multifamily rental properties risk being exposed to substandard living conditions due to decisions they did not make.").

[20] Rasmussen, *supra* note 16.

[21] *See* Eloisa Rodriguez-Dod, *Stop Shutting the Door on Renters: Protecting Tenants from Foreclosure Evictions*, 20 CORNELL J.L. & PUB. POL'Y 243, 245, 247 (2010). Tenants may also risk losing their security deposits. Been & Glashausser, *supra* note 17, at 3.

[22] Raun J. Rasmussen, *When a Landlord Disappears; Bank Held Liable for Maintaining Building During Foreclosure*, N.Y. L.J., Apr. 17, 1996, at 29. "A constructive eviction occurs when there is an abandonment by the tenant because the continued beneficial use of the premises is impossible." Manhattan Mansions v. Moe's Pizza, 561 N.Y.S.2d 331, 332 (Civ. Ct. 1990).

[23] Rasmussen, *supra* note 16. New York, like many other states, has codified the warranty of habitability. *See* N.Y. REAL PROP. LAW § 235-b (McKinney 2006).

[24] Amy C. Cutts & William A. Merrill, *Interventions in Mortgage Default*, *in* BORROWING TO LIVE 204–05 (Nicholas P. Retsinas & Eric S. Belsky eds., 2008) ("The foreclosure process varies widely across states . . . [and] lasts an average of 355 days between the due date of the last payment

introduce additional complexity—such as requiring court approval of, or the lender's consent to, larger expenses.[25] Usually, a temporary receiver has only the income from current rents to pay for upkeep.[26] When a building needs a new roof or boiler, for example, such a major expenditure may be impossible without financial assistance from the owner or lender.[27]

Tenants should not have to bear these costs by enduring falling plaster, peeling paint, recurrent mold, and inadequate heat and hot water, nor should tenants be constructively evicted by housing conditions so unlivable that they are the equivalent of a sheriff or city marshal executing a warrant of eviction. Where an owner has resources and is subject to a court's jurisdiction, the tenants can often hold the owner directly accountable.[28] But where an owner has filed for bankruptcy or has abandoned a failing investment property, the foreclosing lender should step in to pay for needed repairs.[29] Further, fairness may require the lender to pay where the owner's default was inevitable because the lender recklessly made an oversized loan, incentivizing the owner to pressure low-income tenants to leave by withholding

---

made and the loss of the home at a foreclosure sale, but ranged from 248 to 598 days."). More recent estimates reflect the full impact of the crisis. *See* Susan Saulny, *When Living in Limbo Avoids Living on the Street*, N.Y. TIMES (Mar. 3, 2012), http://www.nytimes.com/2012/03/04/us/when-living-in-limbo-avoids-living-on-the-street.html ("In New York, the time to complete a foreclosure has almost quadrupled, from 263 days in 2007 to 1,019 days in 2011.").

[25] *See, e.g.*, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Sept. 9, 2010) (limiting receiver to repairs costing $2,000 or less absent prior court approval or lender consent).

[26] Andrew L. Herz et al., *What to Expect When a Receiver Takes over a Troubled Property (With Mortgage Foreclosure Receiver's Checklist)*, PRAC. REAL EST. LAW., Sept. 2011, at 33, 35; *see also infra* Part II.

[27] *See* Rasmussen, *supra* note 22.

[28] Rasmussen, *supra* note 16.

[29] *Id.* ("[M]any landlords in foreclosure simply won't show up; a default judgment does little to get repairs completed."); *see also* Tess Vigeland, *They Walked Away, and They're Glad They Did*, N.Y. TIMES (Nov. 9, 2011), http://www.nytimes.com/2011/11/09/your-money/life-goes-on-some-find-after-leaving-an-underwater-mortgage.html (describing process of mortgagors avoiding legal proceedings through careful timing).

repairs.[30] Some states and local governments have passed laws requiring foreclosing mortgage lenders to pay for postjudgment upkeep.[31] But for innocent renters who must cope with poor housing conditions during the foreclosure action—from the mortgagor's default until judgment—these laws leave substantial gaps, often spanning years.[32]

This Note argues that courts should extend application of *Milbank*'s equitable rule to hold foreclosing lenders accountable for interim repairs, out of fairness to innocent tenants who face constructive eviction during a foreclosure. Part II provides background on judicial mortgage foreclosure actions and the role of temporary receivers. Part III surveys the remedies currently available for tenants and demonstrates why these measures inadequately protect tenants by leaving a gap period—between default and judgment—during which no one is held responsible for substandard housing conditions. Part IV examines the *Milbank* case and the grounds for holding lenders financially responsible for interim repairs. Part V argues that courts should apply *Milbank*'s equitable test to determine whether the mortgage lender in a foreclosure action should bear the cost of remediating serious housing code and warranty of habitability violations during the pendency of the action, where other financial sources are inadequate. Extending the rule complements existing law requiring postjudgment upkeep, helps prevent neighborhood blight, and places the burden of repairing abandoned apartment buildings on the party best able to bear the cost.

Recognizing that the application of a powerful yet manipulable equitable rule may be somewhat uneven, Part VI recommends that state legislatures establish a duty on the part of foreclosure plaintiffs to pay for needed repairs to multiple

---

[30] *See infra* Part III.

[31] *See, e.g.*, N.Y. REAL PROP. ACTS. LAW § 1307 (McKinney 2009); Mark Oltmanns, *City Fights to Keep Banks Accountable for Blight in Foreclosed Homes*, RICHMOND CONFIDENTIAL (Feb. 10, 2011), http://richmondconfidential.org/2011/02/10/city-fights-to-keep-banks-accountable-for-blight-in-foreclosed-homes/.

[32] *See* City Council Amicus Brief, *supra* note 19, at 8; Rasmussen, *supra* note 22.

dwellings. Additionally, states might require foreclosure plaintiffs to post a compliance bond to cover the anticipated cost of needed repairs. As of this writing, the New York City Council is considering adopting similar legislation, yet if the effort is successful, the local laws face possible preemption challenges. Meanwhile, at the state level, reform faces significant practical and political hurdles. Finally, while this Note focuses on New York law, the argument for the extension of an equitable rule may have wider implications for many U.S. jurisdictions with judicial foreclosure processes.

II. TENANTS AT FORECLOSURE AND THE ROLE OF THE RECEIVER

Thirty-six states permit both judicial and nonjudicial foreclosures; the other fourteen, New York among them, require a judicial process.[33] In New York, the entire process can take years.[34] A foreclosure action usually begins when the borrower (the mortgagor) fails to make payments under the associated promissory note.[35] Then, the lender (the mortgagee) may file an action to foreclose on the mortgaged property.[36] Many actions settle, but if the action proceeds to judgment, the mortgagee will

---

[33] NAT'L LAW CTR. ON HOMELESSNESS & POVERTY, NAT'L LOW INCOME HOUS. COAL., WITHOUT JUST CAUSE: A 50-STATE REVIEW OF THE (LACK OF) RIGHTS OF TENANTS IN FORECLOSURE 7, 7 n. 4 (2009) [hereinafter WITHOUT JUST CAUSE], *available at* http://www.nlchp.org/content/pubs/Without_Just_Cause1.pdf. Nonjudicial foreclosures vary in their precise mechanics, but typically do not involve a judge unless the borrower seeks judicial intervention. *Id.* at 7.

[34] ALVIN L. ARNOLD, REAL ESTATE INVESTOR'S DESKBOOK § 11:32 (3d ed. 2011) (describing reasons some mortgagees seek a deed in lieu of foreclosure, one of them being to avoid the delay and expense of a judicial foreclosure proceeding); Herz et al., *supra* note 26, at 34.

[35] NEIGHBORHOOD ECON. DEV. ADVOCACY PROJECT, PATHS OF A FORECLOSURE IN NEW YORK STATE (2010), http://www.ahphome.org/library/path_of_a_forecosure.pdf [hereinafter PATHS OF A FORECLOSURE]. A mortgage follows the promissory note and remains enforceable by the note holder as it changes hands. N.Y. U.C.C. LAW § 9-203(g) (McKinney 2002); Deutsche Bank Nat'l Trust Co. v. Pietranico, 928 N.Y.S.2d 818, 829 (Sup. Ct. 2011).

[36] PATHS OF A FORECLOSURE, *supra* note 35.

typically request that the court appoint a referee to sell the property to the highest bidder, in order to satisfy the mortgage debt.[37]

In New York, a judgment of foreclosure severs a tenancy, provided the tenant was made a party to the foreclosure action,[38] (though Part III describes some important exceptions to this). Tenants are often named as John or Jane Does in the foreclosure action and are subject to the orders of the foreclosure court.[39] During the foreclosure action, however, the tenancy continues, and the same lease terms and rent remain in effect.[40] For a bank holding the mortgage note on a multiple dwelling, often an investment property, it is problematic for the property to languish and rents go uncollected.[41] A receiver solves this problem, acting as a temporary caretaker, taking in the building's income and maintaining its condition, both for the lender as well as the current occupants.[42] In New York, foreclosure plaintiffs often seek receivers for apartment buildings with six units or more.[43]

---

[37] *Id.*

[38] 6820 Ridge Realty LLC v. Goldman, 701 N.Y.S.2d 69 (App. Div. 1999) (holding that where tenant was not joined in foreclosure action, new owner's remedy was eviction proceeding, not writ of assistance). Other states do not require that tenants be made parties to the foreclosure action. WITHOUT JUST CAUSE, *supra* note 33, at 8.

[39] Milbank Transcript, *supra* note 3, at 16. *But see* 103rd Funding Assocs. v. Salinas Realty Corp., 714 N.Y.S.2d 47, 49 (App. Div. 2000) (failing to intervene below, tenants lacked standing to appeal trial court order).

[40] Ifantides v. Mikeway Enter., Inc., N.Y. L.J., Nov. 27, 1991, at 25 ("[A]bsent fraud or collusive action in anticipation of foreclosure or receivership, pending a judgment of foreclosure and sale the receiver may not collect a higher rent from a tenant than is stipulated in a lease."). Renewal leases entered into during the foreclosure action may change the amount of rent or other terms of the tenancy. Herz et al., *supra* note 26, at 37–38.

[41] *See* Herz et al., *supra* note 26, at 33–34.

[42] *Id.*

[43] *See* Holmes v. Gravenhorst, 188 N.E. 285, 286 (N.Y. 1933) ("Where . . . the mortgagor is not in possession during the foreclosure of [the] mortgage . . . and the premises are occupied by tenants . . . a receiver may be appointed in a proper case to take possession of the premises, collect the rents, and apply them to the payment of the carrying charges on the property

A temporary receiver is an officer of the court, and one may be appointed at the request of the parties to the action, typically the mortgagee-plaintiff.[44] Even though the mortgage agreement may provide for a receiver, courts "exercise extreme caution in appointing receivers . . . because such appointment [generally] results in the taking and withholding of possession of property from a party without an adjudication on the merits."[45] Appointing a receiver effectively terminates the mortgagor's right to collect rents but *not* its ownership of the property.[46] Technically, the owner holds title until the final judgment of foreclosure, even though a court's order appointing the receiver may require the owner to surrender possession.[47]

State law makes clear that the receiver has only those powers conferred by the appointing order.[48] The receiver's presence "is intended to protect the lender from the risk that the borrower will mismanage the property or misappropriate revenue . . . [and] to assure that the property does not deteriorate under the control of a distracted and penniless borrower."[49] Appointing a receiver also allows the lender to insulate itself from liability that could result were it deemed a "mortgagee-in-possession."[50] Acquiring the status of a

---

and the reduction of the mortgage debt."). Anecdotally, receivership is not often used for smaller multifamily buildings. Rasmussen, *supra* note 16.

[44] Herz et al., *supra* note 26, at 34 ("Any well-drafted mortgage usually states that the holder of the mortgage can have a receiver appointed if the lender starts a foreclosure action.").

[45] Jacobowitz v. Jacobowitz, 798 N.Y.S.2d 710 (Sup. Ct. 2004) (unpublished table decision) (quoting Hahn v. Garay, 387 N.Y.S.2d 430, 431 (App. Div. 1976)) (alteration in original) (internal quotation marks omitted).

[46] *In re* Koula Enters, Ltd., 197 B.R. 753, 758 (Bankr. E.D.N.Y. 1996) (applying New York law).

[47] *See, e.g.*, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Sept. 9, 2010) ("All persons now or hereafter in possession of said premises or any part thereof and not holding such possession under valid and existing leases or tenancies do forthwith surrender such possession to said Receiver, subject to emergency laws, if any.").

[48] N.Y. C.P.L.R. 6401(b) (McKinney 2010); Daro Indus., Inc. v. RAS Enters., 380 N.E.2d 160, 161 (N.Y. 1978).

[49] Herz et al., *supra* note 26, at 33–34.

[50] N.Y. GEN. OBLIG. LAW § 9-101 (McKinney 2010) ("A receiver of

"mortgagee-in-possession" will not equate the mortgagee's rights and duties with those of an owner.[51] But a receiver's rights, duties, and powers are even more limited in scope, allowing the mortgagee to limit its potential liability and to insulate itself from most direct claims.[52]

For its necessary expenses, the receiver has priority over other creditors when the property is sold.[53] A receiver's necessary expenses, including the cost of complying with legal duties like the warranty of habitability, "constitute a first charge or lien against the receivership property and funds . . . [with] priority over preexisting liens of mortgagees,"[54] including the plaintiff-mortgagee's lien.[55] Thus, even when the sale price yields less than the amount of the loan, the receiver's necessary interim expenses will usually be covered.[56] Additionally, upon judgment, the receiver may apply for reimbursement from the mortgagee for necessary expenses incurred during the action.[57] Thus, the receiver can be made whole even without a sale: if the lender takes title to the property and keeps it on its books as real estate owned, the receiver may seek reimbursement of necessary expenditures directly from the foreclosing mortgagee.[58]

In New York, a receiver is considered an owner for

---

rents and profits appointed in an action to foreclose a mortgage upon real property shall be liable, in his official capacity, for injury to person or property sustained by reason of conditions on the premises, in a case where an owner would have been liable."); Mortimer v. E. Side Sav. Bank, 295 N.Y.S. 695, 699 (App. Div. 1937) (finding mortgagee-in-possession liable as owner); Herz et al., *supra* note 26, at 34.

[51] Trajam Realty Corp. v. Hirschfeld, 452 N.Y.S.2d 37, 39–40 (App. Div. 1982).

[52] Herz et al., *supra* note 26, at 38.

[53] 91 N.Y. JUR. 2D *Receivers* § 44 (2004) (citing Farmers' Loan & Trust Co. v. Bankers' & Merchants' Tel. Co., 42 N.E. 707 (N.Y. 1896)).

[54] *Id.*

[55] 91 N.Y. JUR. 2D *Receivers* § 84 (2004) (citing Vill. of Stillwater v. Hudson Valley Ry. Co., 174 N.E. 306 (N.Y. 1931); Cent. Trust Co. of N.Y. v. Pittsburgh, S. & N.R., Co., 119 N.E. 565 (N.Y. 1918)).

[56] *See* Corcoran v. Joseph M. Corcoran, Inc., 521 N.Y.S.2d 757, 760 (App. Div. 1987) (allowing receiver to recover attorney's fees).

[57] N.Y. C.P.L.R. 8004(b) (McKinney 1981).

[58] *Id.*; Land v. Esrig, 43 N.Y.S.2d 623, 626 (Sup. Ct. 1943).

purposes of complying with the New York Multiple Dwelling Law and New York City Housing Maintenance Code.[59] Once appointed, the "receiver is charged with the responsibility to 'preserve and protect the property for the benefit of all persons interested in the estate.'"[60] State law further directs courts in New York City to include in their appointing orders that the receiver will give priority to remedying housing code violations.[61]

Ordinarily, the receivership's expenditures are limited to the money it takes in from the property.[62] In many cases, this will not be sufficient to pay for anything beyond basic taxes, fees, and charges (e.g., for water and heating oil).[63] When there is a

---

[59] N.Y. MULT. DWELL. LAW § 4(44) (McKinney 2001); N.Y.C. CHARTER & ADMIN. CODE ANN. §§ 27-2004(45), 27-2005 (N.Y. Legal Publishing Corp. 1993).

[60] Bank of Tokyo Trust Co. v. Urban Food Malls Ltd., 650 N.Y.S.2d 654, 665 (App. Div. 1996) (quoting Jamaica Sav. Bank v. Florizal Realty Corp., 407 N.Y.S.2d 1016, 1018 (Sup. Ct. 1978)). "The legal responsibility of a receiver to maintain the receivership property in good repair is settled law." 79 N.Y. JUR. 2D *Mortgages* § 862 (2003) (citing Griffo v. Swartz, 306 N.Y.S.2d 64, 75 (Cnty. Ct. 1969)). "A receiver in a foreclosure action . . . stands in the shoes of the owner, and has a legal duty to maintain the property in good repair and is liable for damages for the failure to meet that duty." Mercedes v. Menella, 827 N.Y.S.2d 73, 74 (App. Div. 2006) (citing Fourth Fed. Sav. Bank v. 32–22 Owners Corp., 653 N.Y.S.2d 588, 589 (App. Div. 1997)).

[61] N.Y. REAL PROP. ACTS. LAW § 1325(3) (McKinney 2009) ("In a city with a population of one million or more persons an order appointing a receiver to receive the rents and profits of a multiple dwelling shall provide that the receiver . . . expend rents and income and profits as described in subdivision two of this section, except that a priority shall be given to the correction of immediately hazardous and hazardous violations of housing maintenance laws within the time set by orders of any municipal department, or, if not practicable, seek a postponement of the time for compliance."); *see also Memorandum of the City of New York*, *in* 1983 N.Y. LEGIS. ANN. 303 ("[T]enants . . . many times face dangerous health and safety situations. This bill would afford court appointed receivers with proper guidance during the mortgage foreclosure period.").

[62] Herz et al., *supra* note 26, at 35. The receiver may also enter into lease agreements for the premises and take out necessary loans, subject to court approval. *Id.* at 37–38.

[63] *See, e.g.*, City Council Amicus Brief, *supra* note 19, at 14.

deficit, the receiver will look to the foreclosing mortgagee, who is probably the receiver's only source of additional funds.[64] State law *permits* the mortgagee to advance funds to the receiver of a multiple dwelling[65] in order to correct violations, but it does not explicitly require it to do so.[66] Mortgagees typically attempt to recoup these advances as part of the ultimate recovery from the mortgagor.[67] Where the need goes beyond the building's income and any advances, this statutory scheme falls short of meeting the receiver's obligations to innocent tenants.[68]

III. CURRENT LAW INADEQUATELY PROTECTS THE INNOCENT VICTIMS OF FORECLOSURE

The United States faces an unprecedented crisis in the rate of defaults on mortgages. By the end of the current crisis, between 8 and 13 million homes will have been foreclosed on, according to some predictions.[69] Millions more borrowers are "underwater," owing more on their mortgages than their real estate is worth, and are in danger of foreclosure if they fall

---

[64] Herz et al., *supra* note 26, at 35.

[65] N.Y. MULT. DWELL. LAW § 4(7) (McKinney 2001) ("[A] multiple dwelling . . . [is] . . . a dwelling which is either rented, leased, let or hired out, to be occupied, or is occupied as the residence or home of three or more families living independently of each other.").

[66] MULT. DWELL. § 302-b(1) ("[W]here a receiver has been appointed in foreclosure proceedings instituted by a mortgagee with respect to any multiple dwelling, such mortgagee *may* advance to such receiver funds necessary for the operation of such multiple dwelling and for the making of repairs therein necessary to remove conditions constituting violations of this chapter." (emphasis added)).

[67] Herz et al., *supra* note 26, at 35 ("Most mortgage documents do allow the lender to spend money to protect its collateral, and then recover those expenses from the borrower as part of the borrower's secured obligation.").

[68] *But see* Litho Fund Equities, Inc. v. Alley Spring Apartments Corp., 462 N.Y.S.2d 907, 909 (App. Div. 1983) (holding that the court may consider "whether there [a]re special circumstances that make it equitable to impose additional receivership expenses on [the mortgagee] even though the expenses exceed the rent collected").

[69] Vicki Been et al., *Decoding the Foreclosure Crisis: Causes, Responses, and Consequences*, 30 J. POL'Y ANALYSIS & MGMT. 388, 388 (2011).

behind on payments.[70] The end does not appear to be in sight.[71] As recently as August 2011, the number of new mortgage foreclosure filings jumped significantly, and as of March 2012, observers are noting a troubling new trend in foreclosure activity.[72] Nor is the crisis limited to places like Florida, California, Texas, and Arizona, where the bursting housing bubble left neighborhoods dotted with empty "McMansions" and dying lawns.[73] New York City, despite having a relatively stable housing supply, suffered a massive price bubble[74] and has seen a rapid increase in foreclosure filings.[75] And it is not just homeowners who are suffering: experts estimate that more than 20% of the properties in foreclosure nationwide are rentals,[76]

---

[70] Editorial, *On the Road to Relief*, N.Y. TIMES (Oct. 25, 2011), http://www.nytimes.com/2011/10/25/opinion/on-the-road-to-mortgage-relief.html ("Currently, some 14.5 million borrowers are underwater, on average, by $50,000.").

[71] Ann Carrns, *Foreclosure Crisis Isn't Even Halfway Over, Analysis Finds*, N.Y. TIMES (Nov. 30, 2011), http://bucks.blogs.nytimes.com/2011/11/30/foreclosure-crisis-isnt-even-halfway-over-analysis-finds/.

[72] *The Foreclosure Report–August 2011*, FORECLOSURE RADAR, http://www.foreclosureradar.com/foreclosure-report/foreclosure-report-august-2011 (last visited Feb. 18, 2012) (attributing jump to filings by Bank of America); Matthew Yglesias, *Foreclosure Fraud Settlement Filing Leads to Spike in Foreclosure Activity*, SLATE (Mar. 15, 2012), http://www.slate.com/blogs/moneybox/2012/03/15/foreclosure_fraud_settlement_filing_leads_to_spike_in_foreclosure_activity.html.

[73] *See* June Fletcher, *The McMansion Glut*, WALL ST. J. (June 16, 2006), http://online.wsj.com/article_email/SB115042445578782114-lMyQjAxMDE2N TEwNjQxMjY0Wj.html ("McMansions . . . [are] . . . oversized homes—characterized by sprawling layouts on small lots, and built in cookie-cutter style by big developers.").

[74] *See* Edward L. Glaeser et al., *Housing Supply and Housing Bubbles* 28 (Harvard Inst. of Econ. Research Discussion, Paper No. 2158, 2008) ("[M]arkets with highly elastic supply sides are much less likely to have 'bubbles.'").

[75] *Hearings*, *supra* note 1, at 5 (statement of Erik Martin Dilan, Chairperson, Comm. on Hous. & Bldgs. of N.Y.C. Council) ("According to a report published last month by the New York State Co[mp]troller's Office, between the years 2006 and 2009, the number of foreclosure filings within the City of New York rose approximately 32%, to 22,866.").

[76] Aleatra P. Williams, *Real Estate Market Meltdown, Foreclosures and Tenants' Rights*, 43 IND. L. REV. 1185, 1185 n.1 (2010) (citing JOINT CTR.

and in New York City, more than half the families affected by foreclosures are renters.[77]

Tenants of buildings in foreclosure face special challenges. In addition to evictions without cause, foreclosures often lead to a substantial increase in housing code or warranty of habitability violations.[78] Absentee owners may simply abscond with tenants' rent payments without investing in any building upkeep.[79] The problem is especially acute in low-income neighborhoods and communities of color.[80]

Predatory lending has exacerbated the problem of troubled mortgages[81] and has caused many properties to go underwater.[82]

FOR HOUS. STUDIES OF HARVARD UNIV., AMERICA'S RENTAL HOUSING: THE KEY TO A BALANCED NATIONAL POLICY 14 (2008)).

[77] DANILO PELLETIERE, NAT'L LOW INCOME HOUS. COAL., RENTERS IN FORECLOSURE: DEFINING THE PROBLEM, IDENTIFYING THE SOLUTIONS 2 (2009), *available at* http://www.nlihc.org/doc/renters-in-foreclosure.pdf ("In New York City, the Furman Center conservatively estimated that if an owner lived on-site in every multi-unit building and none of the single-family residences in foreclosures were rentals, 50% of the nearly 30,000 families affected by foreclosure were renters.") (citing Press Release, Furman Ctr. for Real Estate & Urban Policy, New Analysis of NYC Foreclosure Data Reveals 15,000 Renter Households Living in Buildings that Entered Foreclosure in 2007 (Apr. 14, 2008), *available at* http://furmancenter.org/files/FurmanRelease_RentersinFore closure_7_14_ 2008.pdf).

[78] VICKI BEEN ET AL., FURMAN CTR. FOR REAL ESTATE & URBAN POLICY, STATE OF NEW YORK CITY'S HOUSING & NEIGHBORHOODS 2010, at 5–6 [hereinafter STATE OF N.Y.C. HOUSING REPORT] ("The analysis finds that buildings receive an average of 21 percent more violations during the specific quarter in which a *lis pendens* is filed, and 15 percent more violations during the two quarters prior to the *lis pendens* issuance and the two quarters after, compared to what the building received in other periods.").

[79] *See* Bob Hennelly, *What Happens When No One Wants to Own a Place*, WNYC (Aug. 15, 2011), http://www.wnyc.org/articles/wnyc-news/2011/aug/15/ what-happens-when-no-one-wants-own-place/.

[80] Justin P. Steil, *Innovative Responses to Foreclosures: Paths to Neighborhood Stability and Housing Opportunity*, 1 COLUM. J. RACE & L. 63, 76–86 (2011); Catherine Dunn, *Foreclosure Crisis Fades to Black and Brown*, CITY LIMITS MAG. (Aug. 15, 2011), http://www.citylimits.org/news/articles/4363/foreclosure-crisis-fades-to-black-and-brown.

[81] *See* Christopher J. Mayer & R. Glenn Hubbard, House Prices, Interest Rates, and the Mortgage Market Meltdown 7–8 (2008) (unpublished

During the latest real estate boom, investors bought up properties in New York and other cities with low rent rolls, hoping to evict tenants paying below-market rents,[83] remove apartments from rent regulation,[84] and re-rent units at market rate.[85] Many such plans were based on unrealistic expectations.[86]

---

manuscript), http://www.nber.org/public_html/confer/2008/cff08/mayer.pdf (attributing worst of crisis to overleveraging real estate values).

[82] Yuliya S. Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1872 (2011) ("[L]enders were to some extent aware of high [loan-to-value] ratios being increasingly associated with risky borrowers."); Angela Maddaloni & José-Luis Peydró, *Bank Risk-taking, Securitization, Supervision, and Low Interest Rates*, 24 REV. FIN. STUD. 2121, 2124 (2011).

[83] "[S]enior citizens, long term tenants, and the disabled. . . . [A]re often singled out by landlords for eviction because they often have been in the apartment for many years and thus pay lower rents." Jambes v. Veale, 504 N.Y.S.2d 982, 986 (Civ. Ct. 1986) (quoting Budhu v. Grasso, 479 N.Y.S.2d 303, 306 (Civ. Ct. 1984) (quoting *Memorandum of Assemblyman Richard N. Gottfried*. *in* 1984 N.Y. LEGIS. ANN. 109 (supporting revisions to N.Y. COMP. CODES R. & REGS. tit. 9, § 2524.4 (2000) (Rent Stabilization Code)))).

[84] State law allows an owner to remove a vacant apartment from rent stabilization by spending forty times the difference between the legal regulated monthly rent and $2,500 (but the owner must spend sixty times the difference in rent in a building with more than 35 apartments). *Fact Sheet #12 – Rent Increases for Individual Apartment Improvements (IAI)*, N.Y. STATE HOMES & CMTY. RENEWAL, http://nysdhcr.gov/Rent/FactSheets/orafac12.htm (last updated July 31, 2011); *see also Fact Sheet #36 – High-Rent Vacancy Deregulation and High-Rent High-Income Deregulation*, N.Y. STATE HOMES & CMTY. RENEWAL, http://nysdhcr.gov/Rent/FactSheets/orafac36.htm (last updated July 2011).

[85] ASS'N FOR NEIGHBORHOOD & HOUS. DEV., PREDATORY EQUITY: EVOLUTION OF A CRISIS 4 (Nov. 2009), *available at* http://www.anhd.org/resources/Predatory_Equity-Evolution_of_a_Crisis_Report.pdf (finding that predatory equity loans "could place up to 100,000 apartments at risk"); *see also* Milbank Tenants' Memorandum of Law, *supra* note 2, at 2 ("The predatory equity model leads inevitably to widespread defaults that undermine the financial system while causing displacement of low income families.").

[86] *See, e.g.*, Terry Pristin, *Tenants Fret Over Big Debt at a Top Address*, N.Y. TIMES (Sept. 21, 2011), http://www.nytimes.com/2011/09/21/realestate/commercial/tenants-anxious-over-next-move-at-a-manhattan-landmark.html ("[T]he Belnord loan was based on unrealistic expectations about how quickly rent-regulated apartments would become vacant.").

Regulated apartments have not become vacant as often, nor have rents increased as much, as owners had hoped.[87] Much of the financing made available to real estate investors who bought rental buildings now appears inappropriately outsized because lenders did not account for realistic rental income, costs of repairs, heating oil or gas, and other necessary expenses on top of the debt service payments, while at the same time, real estate prices and equity have collapsed.[88] Consequently, some owners have purposefully withheld repairs to coerce tenants to vacate their apartments, in order to improve their bottom line.[89]

Repairs are of less concern, however, if tenants also face eviction proceedings because of the foreclosure, but they are crucial for long-term tenants with an interest in staying put.[90] In New York City, many tenants are entitled to renewal leases under the Rent Stabilization Code,[91] or continued tenancy under the Rent Control Law,[92] the benefits of which they may no longer have if forced to move.[93] Outside New York City, similar

---

[87] City Council Amicus Brief, *supra* note 19, at 15.

[88] *Id.*

[89] *Id.* at 10 (describing rationale behind Tenant Harassment Act); E-mail from Shira Galinsky, Staff Att'y, S. Brooklyn Legal Servs., to author (Oct. 20, 2011, 02:15 PM EST) (on file with author) ("[W]ithholding repairs is a very popular method of enhancing turnover." (quoting Posting of Jonathan Levy, Deputy Dir., Hous. Unit, Legal Servs. N.Y.C.–Bronx, Jlevy@bx.ls-nyc.org, to N.Y.C. Hous. Discussion, HousingNYC@wnylc.net (Sept. 15, 2011, 2:29 P.M.))).

[90] *But see* Minjak Co. v. Randolph, 528 N.Y.S.2d 554 (App. Div. 1988) (holding that abandonment due to uninhabitable conditions may absolve the tenant from paying rent).

[91] *See* N.Y. COMP. CODES R. & REGS. tit. 9, § 2524.1 (2000) (provision of the Rent Stabilization Code prohibiting eviction).

[92] *See id.* § 2104.1 (provision of the Rent Control Law prohibiting eviction).

[93] Raun J. Rasmussen, *Defending Rent-Controlled Tenants Against Eviction*, N.Y. L.J., Dec. 8, 1992, at 3 ("Unfortunately for tenants in New York City, many banks fail to investigate the rent regulatory status of the tenants who occupy the building upon which they have foreclosed, and bring meritless motions for writs of assistance. Tenants are confused by the legal papers, confused by the forum, and unable to get legal assistance if they are low income. They therefore fail to appear, fail to assert valid defenses, and end up evicted and homeless."); Rasmussen, *supra* note 16.

laws apply in a handful of jurisdictions.[94] In other states, such as Massachusetts,[95] and in thirteen jurisdictions in California,[96] tenants at foreclosure are protected from eviction without good cause—at least until the property is transferred to a new owner. In addition, current federal law allows all tenants of one-to-four family buildings to continue their valid leases during and after a foreclosure sale, up to the end of the lease term.[97] Federal law also allows recipients of federal Section 8 Housing Choice vouchers, which subsidize private rentals for eligible individuals, to remain in their apartments after a judgment of foreclosure and sale.[98]

It would thwart these laws' purpose if uninhabitable conditions were to lead to constructive evictions. Affordable housing in expensive urban markets like New York City is also threatened if housing conditions deteriorate to the point where constructive evictions lead to tenants leaving, allowing the owners to remove apartments from rent regulation.[99] Legislators at every level of government have enacted protections for paying tenants who, by no fault of their own, risk becoming homeless because of a foreclosure. As the following sections will demonstrate, however, those responses have not adequately

---

[94] Daniel Finkelstein & Lucas A. Ferrara, [F] NEW YORK PRACTICE, LANDLORD AND TENANT PRACTICE IN NEW YORK § 11:1, n.1 (West 2011).

[95] *Compare* MASS. GEN. LAWS ch. 186A, § 2 (2012) ("[A] foreclosing owner shall not evict a tenant except for just cause or unless a binding purchase and sale agreement has been executed for a bona fide third party to purchase the housing accommodation from a foreclosing owner."), *with* An Act Requiring Tenant Protections in Foreclosed Properties, S.B. 1609, 186th Gen. Ct. (Mass. 2009) (proposing further, postsale tenant protections).

[96] Nicole Gon Ochi, *The California Tenant Stability Act: A Solution for Renters Affected by the Foreclosure Crisis*, 17 GEO. J. ON POVERTY L. & POL'Y 51, 65 n.124 (2010) (listing California jurisdictions with "just cause"-type eviction protection measures for tenants at foreclosure).

[97] Protecting Tenants at Foreclosure Act of 2009, Pub. L. No. 111-22, § 701–04, 123 Stat. 1632, 1660–62 (codified at 12 U.S.C. § 5220, 42 U.S.C. § 1437 (Supp. 2010)), *amended by* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1484, 124 Stat. 1376, 2204 (2010)) (clarifying and extending the Protecting Tenants at Foreclosure Act of 2009 until December 31, 2014).

[98] § 701–04, 123 Stat. at 1660–62.

[99] *See infra* Part V.B.1.

addressed the crucial gap period between an owner's default and the moment title passes to a new owner.

A. Federal Statutory Response

Recognizing the plight of tenants at foreclosure, Congress passed the Protecting Tenants at Foreclosure Act of 2009 (PTFA).[100] The PTFA applies to one-to-four family dwellings and provides that, in the case of a foreclosure, any new owner takes title subject to the tenants' bona fide leasehold interests; but if the lease expires, or if the new owner intends to occupy the premises as a primary residence, then the tenant is entitled to ninety days notice before any eviction.[101] The PTFA further protects tenants in any size building who receive federal Section 8 Housing Choice Voucher subsidies.[102] Although the PTFA adds important protections against immediate eviction, it does not address the plight of tenants facing uninhabitable conditions during and after the foreclosure process, which may take years to unfold.[103] Moreover, the PTFA sunsets in 2014.[104] Because the PTFA only applies to buildings "designed principally for the occupancy of from one to four families," it would have only applied to Milbank's tenants who received Section 8 vouchers, and not to the buildings generally.[105] The PTFA is an important

---

[100] § 701–04, 123 Stat. at 1660–62.

[101] *Id*. The PTFA applies to foreclosures of "federally-related mortgage loans," a wide category that includes any loan for a one-to-four family dwelling made by a bank whose deposits are insured by FDIC. 12 U.S.C. § 2602 (2006).

[102] § 701–04, 123 Stat. at 1660–62.

[103] Elan Stavros Nichols, *Unanswered Questions Under the PTFA: Exploring the Extent of Tenant Protections in Foreclosed Properties*, 20 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 153, 165–66 n.90 (2011) (citing Creola Johnson, *Renters Evicted en Masse: Collateral Damage Arising from the Subprime Foreclosure Crisis*, 62 FLA. L. REV. 975, 977, 990 (2010)).

[104] § 701–04, 123 Stat. 1632.

[105] 12 U.S.C. § 2602 (2006). Section 8 voucher recipients are already protected by federal regulations that require owners to meet certain housing quality standards. Housing Quality Standards, 24 C.F.R. § 982.401 (2011); DEP'T OF HOUS. & URBAN DEV., NO. 7420.10G, HOUSING CHOICE VOUCHER PROGRAM GUIDEBOOK 10-1 (2001), *available at* http://www.hud.gov/offices/

step, but it is a temporary measure that does not address habitable conditions for tenants at foreclosure.

B. State Statutory Responses

Similarly, New York law provides additional protections but still leaves substantial gaps. In 2009, Governor David Paterson signed into law Senate Bill S66007,[106] which revised New York Real Property Actions and Proceedings Law (RPAPL) section 1307 to require plaintiffs in foreclosure actions (usually mortgage lenders) who obtain judgments of foreclosure to maintain the foreclosed properties during the period between judgment and sale.[107]

Unfortunately, however, the statute is silent with respect to the crucial period from the mortgagor's default to judgment, when the building may be in the hands of a court-appointed receiver.[108] This period could span several years. The bill as written purports to "relieve[] the plaintiff [i.e., the mortgagee] of the responsibility to maintain the property for the period that a receiver of such property is serving," but it also purports to not "diminish any obligations of the mortgagor or receiver to maintain the property prior to the closing of the title and [to] not diminish or reduce the rights of the parties under existing law against the mortgagor of the property for failure to maintain

---

adm/hudclips/guidebooks/7420.10G/7420g10GUID.pdf.

[106] *Senator Klein Joins Governor Paterson in Signing into Law Landmark Foreclosure Legislation*, N.Y. ST. SENATE, http://www.nysenate.gov/video/2009/dec/15/senator-klein-joins-governor-paterson-signing-law-landmark-foreclosure-legislation (last visited Feb. 20, 2012).

[107] N.Y. REAL PROP. ACTS. LAW § 1307 (McKinney 2009). *But see* Daniel Beekman, *Bank-owned Bronx Buildings 'Ticking Time Bombs'; Wells Fargo and Deutsche Ignore Building Codes*, N.Y. DAILY NEWS (Aug. 2, 2011), http://articles.nydailynews.com/2011-08-02/local/29859994_1_domingo-cedano-deutsche-bank-buildings-department (suggesting banks are ignoring section 1307's mandate); Aarti Shahani, *With Banks As Landlords, Some Tenants Neglected*, NPR (Feb. 23, 2012), http://www.npr.org/2012/02/23/147160871/with-banks-as-landlords-some-tenants-neglected (documenting similar cases in California and Maryland).

[108] *See* REAL PROP. ACTS. LAW § 1307.

such property."[109] Uncertainty about the ability of mortgagees to enter and control the premises during the foreclosure proceeding, when the mortgagor technically retains ownership, would perhaps explain why the legislature declined to extend these obligations to mortgagees during the foreclosure action.[110] In a multiple dwelling foreclosure, however, courts often appoint a receiver, who steps into the shoes of the owner and assumes the duty to maintain the building, but who often lacks the funds to do so.[111]

Not only does it neglect to address this significant gap in time during which tenants are particularly vulnerable, but RPAPL section 1307 also fails to achieve its stated goals. If its purpose is to protect tenants during foreclosure, but the mortgagor cannot afford to make payments on its mortgage, it is likely that the mortgagor cannot afford to pay for upkeep needed to protect those tenants. Many tenants may be constructively evicted long before a judgment is entered. Moreover, if a building deteriorates during the foreclosure action, it may cost the mortgagee more to fulfill its duties under RPAPL section 1307—maintaining the property from judgment to sale—than it would have if the mortgagee had begun making repairs as soon as a receiver stepped in.[112] Finally, there is evidence that foreclosing banks are simply ignoring section 1307's mandate.[113]

---

[109] S.B. 7V § 6, 232 Leg., Spec. Sess. (N.Y. 2009); *see also infra* Part V.

[110] *See Hearings*, *supra* note 1, 80–81 (testimony of Michael P. Smith, President & C.E.O., N.Y. Bankers Ass'n).

[111] *See supra* Part II.

[112] *See* D.C. DEP'T OF CONSUMER & REGULATORY AFFAIRS, No. 680931, STUDY GUIDE FOR PROPERTY MANAGERS EXAMINATION 16 (2011), *available at* http://www.asisvcs.com/publications/pdf/680931.pdf ("Often, by 'investing' in preventive maintenance, the owner will save money by avoiding costly emergency repairs."). For example, reroofing an apartment building to halt leaks may be expensive, but it may be much less expensive to take this preventive step than to wait until the building also requires extensive mold remediation resulting from water leaks. *See* Bill Boles, *Missteps with Mold*, HOME ENERGY, July/Aug. 2002, at 38, 40, *available at* http://www.bestofbuildingscience.com/pdf/Missteps%20with%20Mold%20HEM_19-4_p38-41.pdf.

[113] Beekman, *supra* note 107.

Another, older New York law contemplates a possible community-based approach to abandonment. Article 7A of the RPAPL "provides for the appointment by housing court judges of private administrators to manage residential buildings that have been 'effectively abandoned' by their owners, and in which conditions are 'dangerous to life, health, or safety' of tenants."[114] A third or more of a building's tenants can petition for an administrator.[115] The process can be contentious, lengthy, and time-consuming,[116] however, and it can be difficult for tenants to agree on strategy and to find competent people willing to serve as administrators.[117] As a result, Article 7A–administered buildings remain relatively rare.[118]

Outside New York, similar statutes offer some protection for tenants at foreclosure.[119] Massachusetts law is particularly tenant friendly: new owners who obtain title in a foreclosure sale may not evict existing tenants without just cause.[120] Other states have yet to enact "just cause" measures, but are making limited progress on other fronts.[121] In Texas, for example, although its state laws are even less protective of tenants at foreclosure than the PTFA, the legislature recently passed two measures aimed at helping renters of properties in foreclosure:[122] (1) Texas Justice Courts may now issue orders restoring utility services to renters,

---

[114] HON. G. OLIVER KOPPELL & MOLLY WASOW PARK, N.Y.C. INDEP. BUDGET OFFICE, REVIEW OF THE DEPARTMENT OF HOUSING PRESERVATION AND DEVELOPMENT'S ARTICLE 7A PROGRAM 1 (2003) (quoting N.Y. REAL PROP. ACTS. LAW art. 7A (McKinney 2009)), *available at* http://www.ibo.nyc.ny.us/ iboreports/7amemo.pdf.

[115] *Id*.

[116] For example, the proceeding may first be adjourned several times to allow the owner to attempt to remedy the conditions. *See In re* Dep't of Hous. & Pres. Dev., N.Y. L.J., Oct. 1, 1992, at 21.

[117] Rasmussen, *supra* note 22.

[118] *See* KOPPELL & PARK, *supra* note 114 (finding 123 buildings under 7A administration as of 2003).

[119] WITHOUT JUST CAUSE, *supra* note 33, at 8.

[120] *See supra* note 95 and accompanying text.

[121] WITHOUT JUST CAUSE, *supra* note 33, at 8.

[122] Elizabeth M. Bruman, *Legislative Changes Impacting the Residential Landlord Tenant Relationship in Texas*, HOUS. LAW., Jan./Feb. 2010, at 38, 39–40.

a frequent issue for tenants at foreclosure, and (2) courts may also order repairs costing up to $10,000.[123] It is unclear, however, whether repair orders would be enforceable against anyone but the owner, such as the mortgagee. Like New York, other states have sidestepped the messy issue of who is responsible for repairs during the foreclosure proceeding and have done little to protect innocent tenants from constructive eviction.

C. Local Administrative Responses

Direct government intervention may also protect tenants from hazardous code violations.[124] Where an absent or negligent owner fails to correct serious violations of the Housing Maintenance Code, the New York City Department of Housing Preservation and Development (HPD) may step in to make repairs and restore essential services.[125] The agency then bills the owner or places a tax lien on the property to recoup the amounts expended.[126] Additionally, New York City's Safe Housing Act[127] created an Alternative Enforcement Program to target the city's worst 200 buildings with more focused efforts.[128] But only the most serious cases receive agency attention, government action may be long in coming, and the remedial measures may be merely a stopgap.[129] Moreover, the expense of HPD's emergency

---

[123] *Id.* at 40.

[124] *See* N.Y.C. CHARTER & ADMIN. CODE ANN. §§ 27-2125, 27-2128 (N.Y. Legal Publishing Corp. 1993). Section 27-2005 of the Administrative Code mandates compliance with New York City's Housing Maintenance Code. New York State's warranty of habitability is codified at N.Y. REAL PROP. LAW § 235-b (McKinney 2006).

[125] Rasmussen, *supra* note 16 ("Tenants can get help with some emergencies, such as cascading water leaks and empty boilers, from [HPD].").

[126] N.Y.C. CHARTER & ADMIN. CODE ANN. §§ 27-2125, 27-2128 (N.Y. Legal Publishing Corp. 1993); City Council Amicus Brief, *supra* note 19, at 7.

[127] N.Y.C., N.Y., LOCAL LAW No. 29, Int. No. 561-A (2007); City Council Amicus Brief, *supra* note 19, at 8.

[128] City Council Amicus Brief, *supra* note 19, at 8–9.

[129] Rasmussen, *supra* note 16 ("[F]or conditions that the city considers

repairs are an unnecessary burden on the city budget where a lender has filed a foreclosure action to recover its security for a mortgage loan and sought a receiver to protect the value of that security.[130] These remedies fill a necessary role, but they should be a last resort.

D. Private Ordering

When faced with uninhabitable conditions, tenants may also employ self-help.[131] For example, tenants may band together or solicit charity in order to pay heating bills when an owner fails to supply heat in the dead of winter.[132] Two principal problems with this approach are the inability of poor tenants to pay for self-help, and the uncertain recoupment of expenses, especially where the owner has "walked away" from the property.[133]

Increasingly, community-based organizations are getting involved, sometimes to purchase distressed properties in order to turn them into permanent affordable housing.[134] Although

---

less dangerous, e.g., broken windows, leaky ceilings, mold or rat infestation, tenants may have no recourse but self help.").

[130] *See* City Council Amicus Brief, *supra* note 19, at 7–8 (noting burden). Many of the same cities that face foreclosure crises also face budget shortfalls and have precious few staff devoted to maintaining the quality of private property for renters. *See* Roger Lowenstein, *Broke Town U.S.A.*, N.Y. TIMES (Mar. 3, 2011), http://www.nytimes.com/2011/03/06/magazine/06Muni-t.html (describing cuts to local government services).

[131] Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 589 (App. Div. 1997) ("The tenants . . . claimed to have expended more than $50,000 of their own money in repairs to the building . . . ."); Missionary Sisters of the Sacred Heart v. Meer, 517 N.Y.S.2d 504, 508 (App. Div. 1987) ("[A] tenant may take it upon himself to incur an expense for a repair or service which the landlord is obligated to provide, and he may sue to recover the cost . . . .").

[132] *See* Rasmussen, *supra* note 22.

[133] *See id.*

[134] JOSIAH MADAR ET AL., FURMAN CTR. FOR REAL ESTATE & URBAN POLICY, TRANSFORMING FORECLOSED PROPERTIES INTO COMMUNITY ASSETS 3 (2009), *available at* http://furmancenter.org/files/FurmanCenterWhitePaper_TransformingForeclosedPropertiesIntoCommunityAssets.pdf; Nicholas Hartigan, *No One Leaves: Community Mobilization as a Response to the Foreclosure Crisis in Massachusetts*, 45 HARV. C.R.-C.L. L. REV. 181, 202–

advocates are cautiously optimistic that this mechanism will gain traction and spread, it is still relatively rare.[135] Moreover, the process may simply take too long to make this an appropriate remedy for urgently needed repairs.[136]

Finally, tenants in these situations have a cause of action against the current owners, which they may bring before the foreclosure court or in a separate action.[137] In New York City, state law allows a special part of the Housing Court to hear petitions (called "HP actions") by tenants against owners who fail to comply with the Housing Maintenance Code.[138] Initiating an HP action in Housing Court is fairly simple: claimants fill out a preprinted form and pay a small fee.[139] In contrast, in a foreclosure action involving a receiver, tenants cannot sue the

---

03 (2010); James J. Kelly, Jr., *Refreshing the Heart of the City: Vacant Building Receivership as a Tool for Neighborhood Revitalization and Community Empowerment*, 13 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 210, 210 (2004).

[135] *See* Hartigan, *supra* note 134, at 200–03. Examples of such organizations in New York City include the Fifth Avenue Committee and the Pratt Area Community Council. *See Affordable Housing*, FIFTH AVE. COMM., http://www.fifthave.org/index.cfm?fuseaction=page.viewPage&pageID=610&nodeID=54 (last visited Nov. 19, 2011) ("FAC has built or renovated 600 units of affordable housing for low and moderate- income residents since 1978 and we currently have nearly 400 units in development."); *Housing Development*, PRATT AREA CMTY. COUNCIL, http://pacc.publishpath.com/housing-develop ment (last visited Nov. 19, 2011) ("Since 1988, PACC has developed more than 600 units of housing in more than 65 buildings . . . ."). By contrast, the New York City Housing Authority administers 178,882 units of public housing. *Fact Sheet*, N.Y.C. HOUS. AUTH., http://www.nyc.gov/html/nycha/html/about/fact sheet.shtml (last updated Mar. 18, 2011).

[136] MADAR ET AL., *supra* note 134, at 6, 12, 21, 22, 34 (noting delay, as well as organizational and financial hurdles to closing deals). *But see id.* at 32 (documenting one case where length of time property remained abandoned was shorter than through the regular foreclosure process).

[137] Rasmussen, *supra* note 22.

[138] Hon. Robert F. Dolan, 3 RASCH'S NEW YORK LANDLORD & TENANT INCLUDING SUMMARY PROCEEDINGS § 40:4 (4th ed. 2011).

[139] ASS'N OF THE BAR OF N.Y.C. HOUSING COURT PUB. SERV. PROJECTS COMM. & CIVIL COURT OF N.Y.C., FERN A. FISHER, ADMIN. JUDGE, A TENANT'S GUIDE TO THE NEW YORK CITY HOUSING COURT 19 (2006), http://www.nycbar.org/pdf/report/tenantsguide.pdf.

receiver without leave of the appointing court.[140] Thus, they are forced to make a motion in State Supreme Court, which might entail hiring an attorney familiar with both landlord-tenant and foreclosure law.[141] This is a far more complicated task than beginning an HP action.[142] Additionally, the New York City Tenant Harassment Law[143] makes it illegal for landlords to intentionally harass tenants, which includes disrupting essential services or neglecting to make repairs.[144] But the owner who can no longer keep up with his or her mortgage payments may not even show up when sued, and the tenant plaintiff may be left with a useless judgment, unable to collect.[145] In either case, a lawsuit (or the threat of one) would probably result in a negotiated settlement, but would likely only protect the tenants if that threat were credible. In sum, currently available remedies are inadequate for tenants of buildings in foreclosure who urgently need repairs.

IV. HOUSING ADVOCATES IN NEW YORK CITY EXTEND AN EQUITABLE REMEDY

Tenant advocates have attempted to use existing statutory and case law to protect the vulnerable, but sometimes advocates must

---

[140] Barton v. Barbour, 104 U.S. 126, 127 (1881); Kilarjian v. Kilarjian, 299 N.Y.S.2d 750, 751–52 (App. Div. 1969). *But see* Madison III Assocs. v. Brock, 685 N.Y.S.2d 239, 240 (App. Div. 1999) ("[T]his Court has discouraged resort to Supreme Court where complete relief can be accorded by the Housing Part of the Civil Court.").

[141] *See* Milbank Transcript, *supra* note 3, at 4 ("Mr. Del Valle [counsel for the receiver]: . . . he [a contractor] had brought a motion down there [in Civil Court] asking for permission [to sue the receiver], but the Court said you have to come up to the Supreme Court. He didn't understand. It's a pro se litigant, your Honor.").

[142] *See, e.g.*, Wash. Mut. Bank v. Browne, No. 27151/08 (N.Y. Sup. Ct. Kings Cnty. Oct. 5, 2009) (denying a motion similar to that granted in *Milbank*, but authorizing the tenants to bring an HP action in Housing Court).

[143] N.Y.C., N.Y., LOCAL LAW NO. 7 INT. NO. 627-A (2008).

[144] City Council Amicus Brief, *supra* note 19, at 10.

[145] Rasmussen, *supra* note 16 ("[M]any landlords in foreclosure simply won't show up; a default judgment does little to get repairs completed."); Rasmussen, *supra* note 22.

push the envelope. In 1996, before the enactment of RPAPL section 1307, a New York trial court ordered a foreclosing bank to make repairs to a long-neglected property.[146] The bank had already won a judgment, but it had allowed twenty-nine months to elapse before requesting a sale.[147] Meanwhile, the tenants suffered without heat or hot water and with other dangerous conditions.[148] Significantly, the bank had become the legal owner of the premises, and therefore compelling it to maintain the premises was novel but relatively straightforward.[149] State law now codifies such a duty, but it would take twelve years after this action for the legislature to pass this provision into law.[150] Even after RPAPL section 1307's enactment, tenants still often face poor housing conditions during and after foreclosure proceedings.[151] This is illustrative of a broader problem: statutory and court-made law have not brought relief for tenants in certain circumstances. Faced with few viable options, tenant advocates have turned to making equitable arguments before foreclosure courts.[152] This Part summarizes the facts in *Milbank* and the equitable rule that the court applied.

A. The Facts of Milbank

As foreclosure filings have increased during the financial crisis and overwhelmed court dockets, for some tenants, the gap period that RPAPL section 1307 leaves open has become

---

[146] Dep't of Hous. Pres. & Dev. v. Greenpoint Sav. Bank, 646 N.Y.S.2d 601, 604 (Civ. Ct. 1995); *see also* Rasmussen, *supra* note 22. N.Y. REAL PROP. ACTS. LAW § 1307 (McKinney 2009).

[147] *Greenpoint Sav. Bank*, 646 N.Y.S.2d at 691.

[148] *Id.* at 604.

[149] *Id.*

[150] REAL PROP. ACTS. § 1307.

[151] *See* Beekman, *supra* note 107 (suggesting banks are ignoring section 1307's mandate); Shahani, *supra* note 107.

[152] *See, e.g.*, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Dec. 20, 2011) (granting motion similar to that in *Milbank*); N.Y. Cmty. Bank v. 1255 Longfellow LLC, No. 306660/10 (N.Y. Sup. Ct. Bronx Cnty. Aug. 12, 2010) (filing with similar motion pending).

interminable. In a recent case in New York Supreme Court for Bronx County, a mortgagee sought to foreclose on ten large apartment buildings.[153] With some 4,300 housing code violations, the buildings were in terrible shape.[154] A quarter of the 548 units were vacant and uninhabitable, but the rest had tenants, who suffered through conditions ranging from intermittent heat and hot water to leaks and mold.[155] On the tenants' motion, the Supreme Court ordered the mortgagee to advance $2.5 million to the receiver, enough to correct the immediately hazardous conditions.[156]

In November 2006, Los Angeles–based Milbank Real Estate Services began investing in its Bronx portfolio, financing the purchase of ten apartment buildings with a $35 million loan from Deutsche Bank.[157] The bank repackaged the mortgage into a $3 billion mortgage-backed securities trust named "COMM-2006-C8," ("the Comm trust") which, in turn, was sold to investors.[158] When Milbank's investment soured, it stopped paying its mortgage, and the Comm trust began a foreclosure action,[159] creating a special-purpose limited-liability company to serve as plaintiff.[160] It named as defendants the Milbank group's five LLCs, in which Milbank had placed title to the Bronx properties, two personal guarantors, several NYC agencies that might have had liens on the properties, and twenty-five John

---

[153] *Milbank*, No. 380454/09 (N.Y. Sup. Ct. Bronx Cnty. Sept. 29, 2010).

[154] Milbank Transcript, *supra* note 3, at 11.

[155] *Id*. at 12.

[156] *Milbank*, No. 380454/09 (granting motion "for reasons stated on the record"); Milbank Transcript, *supra* note 3, at 20.

[157] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1; Affidavit of Whitney Wheeler in Opposition to Order to Show Cause at paras. 7–14, *Milbank*, No. 380454/09 [hereinafter Wheeler Affidavit].

[158] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1; Wheeler Affidavit, *supra* note 157, at paras. 7–14. For background on mortgage securitization, see GEORGE LEFCOE, REAL ESTATE TRANSACTIONS, FINANCE AND DEVELOPMENT 177–80 (6th ed. 2009).

[159] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1.

[160] Supplemental Affidavit of Whitney Wheeler in Opposition to Order to Show Cause at para. 3, *Milbank*, No. 380454/09 [hereinafter Wheeler Supplemental Affidavit].

Does.[161] The plaintiff sought a receiver, and the court appointed Consolato Cicciu ("the receiver") in March 2009.[162]

The receiver complained that he did not have anywhere near the funds he needed to comply with the appointment order, which required him to maintain the premises and to correct "hazardous and immediately hazardous violations"[163] of the Housing Maintenance Code.[164] Though the Comm trust opposed the tenants' motion, it admitted that "the status quo is untenable."[165] The trust pointed out that it had already advanced over $1 million to the receiver for repairs, as the law permitted but did not require it to do.[166] The receiver, however, reported that he used the money to pay current water and heating oil bills, and that none of it was spent to correct violations.[167] The tenants stressed that the equities favored an order requiring the lender to advance additional funds to correct hazardous conditions.[168]

---

[161] Wheeler Affidavit, *supra* note 157, at paras. 7–14. The plaintiff had moved to dismiss against the John Doe defendants, and claimed the tenants lacked standing to bring their motion, but the court had reserved decision on the motion to dismiss against the John Doe defendants and declined to dismiss the tenants' motion for lack of standing. Milbank Transcript, *supra* note 3, at 14, 16.

[162] Amended Affidavit of Cicciu, *supra* note 8, at para. 2.

[163] This tracks the language of N.Y. REAL PROP. ACTS. LAW § 1325 (McKinney 2009). "Hazardous" and "Immediately Hazardous," further correspond to "B" and "C" violations, definitions of which are promulgated by local authorities. *HPD Online Glossary*, HPD, http://www.nyc.gov/html/hpd/ html/pr/hpd-online-glossary.shtml (last visited Nov. 20, 2011) ("The law establishes three classes of violations which are: 'A', non-hazardous; 'B', hazardous; or 'C', immediately hazardous.").

[164] Amended Affidavit of Cicciu, *supra* note 8, at paras. 8–16.

[165] Milbank Transcript, *supra* note 3, at 19.

[166] Plaintiff's Memorandum of Law in Opposition to Non-Party Tenants' Application for an Order Directing the Court-Appointed Receiver to Cure All Code Violations and to Compel Plaintiff to Advance the Funds Necessary to Do So at 2, *Milbank*, No. 380454/09 (N.Y. Sup. Ct. Bronx Cnty. Mar. 17, 2009) [hereinafter Brief of Comm 2006-C8] (describing advancing funds to the receiver pursuant to N.Y. MULT. DWELL. LAW § 302-b(1) (McKinney 2001)).

[167] Amended Affidavit of Cicciu, *supra* note 8, at paras. 14–15.

[168] Tenant-Defendants' Brief in Reply to Plaintiff's Opposition and in Further Support of Tenant-Defendants' Order to Show Cause at 8–12, *Milbank*, No. 380454/09 [hereinafter Reply Brief of Tenant-Defendants].

In granting the tenants' motion, the *Milbank* court relied on its equitable power, as well as on state law (RPAPL section 1325) providing that a receiver's priority is to correct housing code violations.[169] That a foreclosure court should fashion an equitable remedy is not all that surprising—traditionally, foreclosures were actions at equity,[170] and today, foreclosure courts still have the power to create a suitable remedy that does substantial justice among the parties before them, even without a statute or precedent to guide them.[171] As far as ordering a mortgagee to advance funds to a receiver, one court expressed its equitable function as follows: "[t]he plaintiff may not be heard to object when called upon to meet an ordinary obligation necessarily and obviously incidental to the relief which he himself sought, obtained and from which he reaped benefits."[172] Following these guideposts, the *Milbank* court held that the statutory postjudgment recoupment procedure was not an *exclusive* remedy,[173] and that an equitable remedy could exist alongside the statutory one, even before a judgment.

---

[169] Milbank Transcript, *supra* note 3, at 19 ("[It] seems to me the equity's here . . . ."); N.Y. REAL PROP. ACTS. LAW § 1325(3)(b) (McKinney 2009); *see also Memorandum of the City of New York*, *supra* note 61.

[170] Graf v. Hope Bldg. Corp., 171 N.E. 884, 886 (N.Y. 1930) (Cardozo, J., dissenting) ("There is no undeviating principle that equity shall enforce the covenants of a mortgage, unmoved by an appeal *ad misericordiam* [to pity], however urgent or affecting. The development of the jurisdiction of the chancery is lined with historic monuments that point another course.").

[171] *See In re* Foreclosure of Tax Liens, 872 N.Y.S.2d 805, 805 (App. Div. 2009) (reversing a holding that "would result in a disproportionately harsh result"); Domansky v. Berkovitch, 687 N.Y.S.2d 41, 42 (App. Div. 1999) (affirming money judgment as "necessary to the accomplishment of the directives set forth in the order of appointment, and also serving to protect and preserve the [property] during the pendency of the action"); Lirosi v. Elkins, 453 N.Y.S.2d 718, 723 (App. Div. 1982) ("[A] court of equity is not precluded from fashioning a suitable remedy, although precedent is wanting."); Caspert v. Anderson Apartments, 94 N.Y.S.2d 521, 525 (Sup. Ct. 1949) ("Equity follows the law, but not slavishly nor at all times." (quoting *Graf*, 171 N.E. at 886) (internal quotation marks omitted)).

[172] Land v. Esrig, 43 N.Y.S.2d 623, 626 (Sup. Ct. 1943).

[173] Milbank Transcript, *supra* note 3, at 18; N.Y. C.P.L.R. 8004(b) (McKinney 1981); *see also* Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 590 (App. Div. 1997); Bankers Fed. Sav. Bank F.S.B. v. Off W. Broadway Developers, 638 N.Y.S.2d 72 (App. Div. 1996).

B. The Milbank *Court's Application of a Four-Factor Equitable Test*

The tenants urged the court to employ a four-factor balancing test, drawn from several appellate and lower court decisions, to examine (1) the degree of necessity of the expenses; (2) whether there would be a benefit to the party that requested a receiver be appointed; (3) whether the foreclosing mortgage lender was aware that the building income would be insufficient to pay the receiver's expenses when it asked that one be appointed; and (4) whether the funds would be judiciously expended.[174] That the properties were overleveraged and "underwater" may also have contributed to the court's analysis.[175] The tenants argued that, at some level, it was the mortgage lender's fault for having initially made an overly risky loan.[176] At oral argument, the court heard details on each factor of the test. While the court's reasoning and application are not always laid bare in the transcript, the record contains enough facts to support its conclusion, which the court memorialized in a one-page short form order.[177]

1. Necessity of Expenses

First, the court had to determine that the money the tenants asked the Comm trust to advance was actually needed. In *Milbank*, the repairs were surely necessary. With more than 4,300 violations, 756 of them immediately hazardous "C" violations (the most serious category established by the City Department of Housing Preservation and Development),[178] the

---

[174] Milbank Transcript, *supra* note 3, at 10; *see also Fourth Fed. Sav. Bank*, 653 N.Y.S.2d at 590; Litho Fund Equities, Inc. v. Alley Spring Apartments Corp., 462 N.Y.S.2d 907, 909 (App. Div. 1983); First N.Y. Bank for Bus. v. T155 E. 34 Realty Co., 601 N.Y.S.2d 990, 993 (Sup. Ct. 1993).

[175] Reply Brief of Tenant-Defendants, *supra* note 168, at 1–4.

[176] *Id.*

[177] *Milbank*, No. 380454/09 (N.Y. Sup. Ct. Bronx Cnty. Mar. 17, 2009) (granting motion "for reasons stated on the record"); Milbank Transcript, *supra* note 3, at 20.

[178] *HPD Online Glossary*, *supra* note 163 ("The law establishes three

ten buildings were literally falling apart.[179] The roofs were leaking, and mold was growing.[180] Despite boiler repairs that the plaintiff claimed were completed, the buildings had a history of lacking heat even after repairs were supposedly done.[181] The court heard argument on September 29, just days before New York City's "heat season" typically begins on October 1.[182]

The Comm trust had already advanced more than $1 million to the receiver, which the trust claimed was spent repairing or replacing boilers and elevators and fixing gas leaks.[183] But the receiver stated that these funds were only enough to pay water and fuel bills, along with the buildings' insurance premiums and real estate taxes.[184] The Comm trust also argued that the court should not interfere with the status quo because a sale was imminent, and that the fact that the city agency charged with correcting serious violations had decided to take no action suggested that the repairs could await this sale.[185] But the court was more convinced by the fact that the case had already languished for eighteen months on the court's calendar.[186] In rejecting plaintiff's counsel's suggestion that

---

classes of violations which are: 'A', non-hazardous; 'B', hazardous; or 'C', immediately hazardous.").

[179] *See* Milbank Transcript, *supra* note 3, at 10–11.

[180] *Id.* at 7 ("Mr. Levy [tenants' counsel]: . . . something [on] the order of five million dollars would make it possible for the receiver to repair the roof so [that] when they go in and correct the mold in somebody's bathroom it doesn't just leak the next time it rains and the mold reoccurs.").

[181] Reply Brief of Tenant-Defendants, *supra* note 168, at 7.

[182] *Heat and Hot Water*, HPD, http://www.nyc.gov/html/hpd/html/tenants/heat-and-hot-water.shtml (last visited Nov. 27, 2011) (describing legal requirement for owners to provide heat to tenants).

[183] Brief of Comm 2006-C8, *supra* note 166, at 2–3.

[184] Amended Affidavit of Cicciu, *supra* note 8, at paras. 14–16.

[185] Milbank Transcript, *supra* note 3, at 15 ("Mr. Tross [plaintiff's counsel]: . . . . If the properties are in such disrepair, and I'm not saying they're not, they are in disrepair, but if the City felt that something urgently needed to be done they could take over these buildings and manage the buildings themselves. They have not seen fit to do it and, quite frankly, the reason for that is we've met with the City counsel, we've met with HPD. They know exactly what we're working on and they are confident that what we're working on is the correct solution here . . . .").

[186] *Id.* at 17 ("The Court: . . . . [Y]ou're suggesting [that the sale i]s going to happen within the week, but I heard that two weeks ago, that it was

the repairs were not urgently needed, the court implicitly found that they were necessary.

2. Benefit to the Mortgagee

The tenants also argued that the equities weighed in their favor because improving the *Milbank* properties would actually inure to the benefit of the plaintiff. They argued—and plaintiff did not dispute—that in particular, improvements would arrest the deterioration of the mortgagee's security.[187] Indeed, many of the units in Milbank's buildings were uninhabitable and generated no income.[188] Repairing the properties to a rentable state would likely begin to show returns quite rapidly.[189] In addition to preserving the value of its collateral, the Comm trust would also benefit from avoiding fines or penalties assessed against the property for failure to correct violations.[190] On the other hand, making extensive repairs may have been out-of-sync with Milbank's investment strategy. Some of the units were fire-damaged, and perhaps Milbank may have wanted to tear down one of the buildings and rebuild instead of repairing the fire-damaged units (in which case repairing those units would have

---

going to happen within two weeks, and before that I heard that again and again and again.").

[187] *Id.* at 10; *see also* Idan Holding Corp. v. 244 Water Realty Corp., 154 N.Y.S.2d 396, 397 (Sup. Ct. 1956) ("[T]he preservation of the property inures to the benefit of the plaintiff whether he subsequently becomes the purchaser at the foreclosure sale or whether he preserves it merely because he may receive full value therefore when the sale is held.").

[188] Amended Affidavit of Cicciu, *supra* note 8, at para. 10 ("[T]he vacancy rate, which was 10%, upon my initial appointment, is now approaching 25%.").

[189] *See* Jemrock Realty Co. v. Krugman, 899 N.Y.S.2d 161, 163 (App. Div. 2010), *appeal dismissed*, 936 N.E.2d 913 (finding owner had met burden of showing it was entitled to a rent increase for a rent-regulated apartment); *see also supra* note 84 (describing method for removing apartments from rent regulation). While deregulating an apartment would certainly help increase the building's profitability, it is less likely to occur in The Bronx than in Manhattan, and at bottom, any rent is better than no rent.

[190] *See Contempt and Penalties*, N.Y.C. HOUS. COURT, http://nycourts.gov/courts/nyc/housing/contempt.shtml (last visited Jan. 20, 2012).

been a waste of time and money),[191] but the Comm trust offered no such rationale. In the end, the court was more "concerned about the condition of the apartments where there are people living" and did not inquire at length into whether the $2.5 million payment would benefit the Comm trust.[192]

3. Foreseeable Deficit

The court did, however, consider the fairness of imposing a new cost on a mortgagee in a foreclosure action when it might not have foreseen the new cost arising.[193] The idea is to avoid undue surprise by holding a party liable for hidden defects when it has only a bare financial interest in the building.[194] This part of the test examines only what the plaintiff (even if it is not the original lender) knew at the time it sought the receiver.[195] Finally, it focuses on the receivership and considers the futility of appointing a caretaker for a property who is unable to take care of it.[196] The conditions of the *Milbank* properties had been so poor for so long that the plaintiff should have known that the receivership would suffer a deficit if the receiver attempted to comply with his statutory duties by bringing the buildings up to code.[197] Thus, the *Milbank* court did not find foreseeability much of a hurdle in directing the payment.[198]

---

[191] *See Fact Sheet #11: Demolition*, N.Y. STATE HOMES & CMTY. RENEWAL, http://www.dhcr.state.ny.us/Rent/FactSheets/orafac11.htm (last updated Nov. 30, 2008).

[192] Milbank Transcript, *supra* note 3, at 12.

[193] *Id.* at 12–13 ("The Court: Are you consenting to th[e tenants'] application? Mr. Tross [plaintiff's counsel]: No, your Honor. The Court: Why not? You asked for the receiver. You knew the buildings weren't in great shape.").

[194] *But see* LEFCOE, *supra* note 158, at 107 ("Buyers of commercial property take physical inspections seriously . . . [M]ost institutional lenders . . . can look to professional 'due diligence' service providers.").

[195] *See infra* Part V.B.2.

[196] *See* Herz et al., *supra* note 26, at 33–34.

[197] Amended Affidavit of Cicciu, *supra* note 8, at para. 16 ("It is abundantly clear to all that the Buildings['] problems cannot be addressed via the current rent roll.").

[198] Milbank Transcript, *supra* note 3, at 12–13, 18–19.

4. Judicious Expense

Spending money to fulfill a duty under law, remediating immediately hazardous conditions, repairing fire damage, stopping cascading leaks, and supplying heat and hot water to poor Bronx tenants are, this Note argues, the definition of "judicious."[199] International law as well as many scholars and advocates recognize decent, quality housing as a human right.[200] In many ways, New York State and New York City law echo this sentiment, such as by requiring receivers to prioritize remediating violations of the Housing Maintenance Code.[201]

Not only should the money be spent on justifiable ends, but the amount should also be reasonable with respect to the need. The tenants estimated that this work would cost about $5 million.[202] The plaintiff argued that the law did not require it to pay anything.[203] Splitting the difference, the *Milbank* court directed the plaintiff to advance $2.5 million to the receiver, leaving open the possibility of directing the plaintiff to advance more funds later.[204] In the end, $2.5 million will go a long way, if not to correct all the serious, open violations, then at least to

---

[199] *See* City of New York v. 629 Ltd. P'ship, 519 N.Y.S.2d 779, 782 (Sup. Ct. 1987).

[200] Chester Hartman, *The Case for a Right to Housing*, *in* A RIGHT TO HOUSING: FOUNDATION FOR A NEW SOCIAL AGENDA 177, 179, 187–88 n.8 (Rachel G. Bratt et al. eds., 2006) (citing various sources of international law containing right-to-housing provisions).

[201] N.Y. REAL PROP. ACTS. LAW § 1325(3)(b) (McKinney 2009) ("[P]riority shall be given to the correction of immediately hazardous and hazardous violations of housing maintenance laws.").

[202] Milbank Transcript, *supra* note 3, at 7.

[203] *Id.* at 13.

[204] *Id.* at 20. The plaintiff obtained a stay from the Appellate Division, but the stay was later vacated on the tenants' motion. The parties have since settled, and a new purchaser has agreed to make all the needed repairs. E-mail from Ian Davie, Staff Att'y, Legal Servs. N.Y.C.–Bronx, to author (Sept. 6, 2011) (on file with author) (explaining that among the settlement terms, the Comm trust agreed to "pay heat/hot water through the winter, fix a crumbling retaining wall, fix an elevator . . . and perfect . . . [its] appeal by a certain date," while a deal was "hashed out . . . with the new buyer/landlord . . . [giving the] tenants some protection.").

correct the most serious violations—or, as happened here, to force a settlement.

V. FORECLOSURE COURTS SHOULD EXTEND EQUITABLE REMEDIES FOR TENANTS

Milbank was correctly decided, and New York foreclosure courts should apply its reasoning to hold foreclosing mortgagees accountable for conditions that threaten tenants' safety or well-being.[205] In order to protect tenants of apartment buildings in foreclosure, particularly those that are not owner-occupied, courts should require the foreclosing mortgagee to bear the unmet cost of needed repairs during the foreclosure action. Precedent and equity provide a legal framework to support this rule, and public policy concerns grounded in efficiency and common-sense fairness undergird it.

A. Legal Framework for Holding a Foreclosing Mortgage Lender Liable

Though somewhat novel, there is a sound legal basis to hold the foreclosing mortgagee accountable under an equity rule, especially where a receiver is appointed. A receiver in a foreclosure action stands in the shoes of the owner, and has a "legal duty to maintain the property in good repair and is liable for damages for the failure to meet that duty."[206] Because the receiver is a court-appointed officer, the court can order it to comply with legal duties.[207] State law provides for postjudgment recoupment

---

[205] Tenant advocates are currently seeking to extend *Milbank* in order to provide relief to tenants in foreclosed properties who, by no fault of their own, suffer from a lack of repairs. *See, e.g.*, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Dec. 20, 2011) (granting similar motion); N.Y. Cmty. Bank v. 1255 Longfellow LLC, No. 306660/10 (N.Y. Sup. Ct. Bronx Cnty. Aug. 12, 2010) (filing with similar motion pending).

[206] Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588 (App. Div. 1997) (citing N.Y. GEN. OBLIG. LAW § 9-101 (McKinney 2010)); *see supra* Part II.

[207] *In re* Kane, 553 N.E.2d 1005, 1007 (N.Y. 1990).

from the mortgagee for the receiver's necessary expenditures, but it is, by its terms, not an exclusive remedy.[208] But imposing liability on a foreclosing mortgagee who is not yet an owner is doctrinally problematic.[209] Because the warranty of habitability and other duties apply only to an "owner," the more difficult case is one in which the mortgagee has not yet won a judgment in a foreclosure action, and is, therefore, not the legal owner.[210] However, laws requiring postjudgment advances and permitting prejudgment advances from mortgagee to receiver[211] suggest that the state legislature did not intend that receivers should bear maintenance costs alone. Appointed receivers may have a legal duty to correct Housing Maintenance Code violations, but there is no expectation that they use their own personal funds to do so.[212]

Courts have begun to recognize that they can craft equitable rules to bridge this problematic statutory gap. In *Fourth Federal Savings Bank v. 32-22 Owners Corp.*, the Appellate Division reasoned (in dicta) that a court might order the mortgagee to make an advance to the receiver when the order appointing the receiver contemplated further expenses beyond the receiver's available funds, thus requiring court approval.[213] Tracking the language of the statute, there the appointing order also "required the receiver to 'make repairs necessary to the preservation of the property' and to give priority to 'the correction of immediately hazardous and hazardous violations of housing maintenance laws.'"[214] In light of this, the court could "order the person who

---

[208] N.Y. C.P.L.R. 8004(b) (McKinney 1981).

[209] Union Sav. Bank v. 285 Lafayette Assocs., *supra* note 15, at 21; Dep't of Hous. Pres. & Dev. v. Greenpoint Sav. Bank, 646 N.Y.S.2d 601, 605–06 (Civ. Ct. 1995) (holding bank liable for fines, pre-RPAPL section 1307, where bank already won a judgment but allowed twenty-nine months to elapse between judgment and sale, during which time it failed to maintain the premises or provide heat and hot water).

[210] N.Y. MULT. DWELL. LAW § 4(44) (McKinney 2001) (defining "owner"); Union Sav. Bank v. 285 Lafayette Assocs., *supra* note 15, at 21.

[211] C.P.L.R. 8004(b) (postjudgment); MULT. DWELL. § 302-b(1) (prejudgment).

[212] Herz et al., *supra* note 26, at 38.

[213] Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 589–90 (App. Div. 1997).

[214] *Id.* at 589 (quoting the appointing order, tracking the language of

applied for the receiver—in this case, plaintiff bank—to pay for necessary expenditures in cases where the receiver lacks the funds to do so."[215] The court reasoned that, "if such necessary repairs were funded by rents paid by the tenants . . . [it] would lead to the inequitable result of compelling tenants to advance funds for housing which they are not receiving."[216] Breach of the warranty of habitability, after all, is a defense to an eviction proceeding for nonpayment of rent, and state law recognizes that tenants need not pay (full) rent for apartments that are fire-damaged, unheated, or lacking other essentials.[217] *Fourth Federal* merely recognizes that this principle ought not change in the event the owner faces foreclosure. Therefore, courts should require prejudgment advances where the circumstances call for it, and where equity supports it.[218]

B. Weighing the Equities in Multiple Dwellings in Foreclosure

Considering all the circumstances includes considering the mortgagee's position as well as that of innocent tenants. Keeping the building in good repair is necessarily and obviously incidental to the mortgagee's purpose, and often benefits its bottom-line.[219] The rational profit-maximizing mortgagee must wish to preserve the value of the mortgaged property—the collateral for its loan—during the foreclosure action,[220] because it usually ends up selling the building to recoup unpaid amounts due from the mortgagor.[221] In the event of a sale, a building in

---

N.Y. REAL PROP. ACTS. LAW § 1325(3)(b) (McKinney 2009)).

[215] *Fourth Fed. Sav. Bank*, 653 N.Y.S.2d at 590 (citing C.P.L.R. 8004(b)).

[216] *Id.*

[217] *See* Jenkins v. Fieldbridge Assocs., LLC, 877 N.Y.S.2d 375, 376 (App. Div. 2009) (enforcing rent reduction order issued by state agency).

[218] *Fourth Fed. Sav. Bank*, 653 N.Y.S.2d at 589–90; City Council Amicus Brief, *supra* note 19, at 15 n.49.

[219] *See supra* Part IV.B.2.

[220] *See* Litho Fund Equities, Inc. v. Alley Spring Apartments Corp., 462 N.Y.S.2d 907, 908 (App. Div. 1983).

[221] N.Y. REAL PROP. ACTS. LAW § 1354 (McKinney 2009). Perhaps, if

better condition commands a higher price.[222] Likewise, a mortgagee who retains the property would benefit from its better condition by being able to command higher rents.[223] Tenant advocates have pointed out, and this Note also urges, that there are other, less obvious equitable considerations to balance: the circumstances surrounding the building's financial condition when the loan was originated, who the plaintiff is, the availability of funds, and broader effects such as blight. Taken together, it is often unfair to impose the cost of repairs during a gap period (or the cost of suffering without repairs) on innocent tenants rather than on foreclosing mortgagees.

1. Holding Reckless Lenders Accountable

As described above in Part III, predatory equity has wreaked havoc on affordable housing and has worked to pull apart diverse, urban neighborhoods by giving owners perverse incentives to push out tenants paying below-market rents. Although owners may face direct liability for harassing tenants, there is also support for finding mortgagees liable at equity when the lender's participation in such a plan was reckless or

---

there is a settlement, the mortgagor retains the building for at least some time, during which the mortgagee benefits from the mortgagor's continued payments on the mortgage note. AM. SECURITIZATION FORUM, STATEMENT OF PRINCIPLES, RECOMMENDATIONS AND GUIDELINES FOR THE MODIFICATION OF SECURITIZED SUBPRIME RESIDENTIAL MORTGAGE LOANS 1 (2007), *available at* http://www.americansecuritization.com/uploadedFiles/ASF%20Subprime%20Loan%20Modification%20Principles_060107.pdf ("The modification provisions that govern loans that are in default or reasonably foreseeable default typically also require that the modifications be in the best interests of the securityholders or not materially adverse to the interests of the securityholders.").

[222] Idan Holding Corp. v. 244 Water Realty Corp., 154 N.Y.S.2d 396 (Sup. Ct. 1956) ("[T]he preservation of the property inures to the benefit of the plaintiff whether he subsequently becomes the purchaser at the foreclosure sale or whether he preserves it merely because he may receive full value therefore when the sale is held."); Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 845 (1980).

[223] *See In re* Lincoln Square Slum Clearance Project, 222 N.Y.S.2d 786, 797 (App. Div. 1961).

negligent and injured tenants.[224] In the run-up to the 2008 market collapse, many banks turned a blind eye to the foreseeable harm their actions posed to third parties.[225] Although many individual loan officers probably did not consider the effect that lax underwriting and oversize loans would have on long-term tenants of properties being purchased, large institutions should have been aware of troubling trends.[226] Their customers, especially purchasers of distressed properties, generally view remaining tenants as a costly nuisance.[227] But prearranging tenant harassment and coercion through unsustainable financing is another story. Putting tenants' feet to the fire by withholding services or repairs is illegal.[228] Investors who state their intent to

---

[224] City Council Amicus Brief, *supra* note 19, at 15 ("[A] bank's decision to offer [a] disproportionately high level of funding—i.e., 'overleveraging' the property—often contributes to the owner's default, the physical deterioration of the building and the receiver's inability to fund maintenance and repairs from the rent rolls."). *But see* LEFCOE, *supra* note 158, at 193 ("[T]he concept of suitability has little current support in the case law . . . . [L]enders do not even owe borrowers the duty of care to avoid negligence in the lending process.").

[225] Michael Lewis, *It's the Economy, Dummkopf!*, VANITY FAIR (Sept. 2011), http://www.vanityfair.com/business/features/2011/09/europe-201109 ("[T]raders may have sunk their firms by turning a blind eye to the risks in the subprime-bond market, but they made a fortune . . . and have for the most part never been called to account.").

[226] City Council Amicus Brief, *supra* note 19, at 15.

[227] Bruce J. Bergman, *So Your Client Wants to Buy at a Foreclosure Sale: Pitfalls and Possibilities*, N.Y. ST. B. J., Sept. 2003, at 43, 45 ("[I]n a perfect world, the defaulting borrower, or his tenants, would quietly depart the foreclosed premises after the foreclosure sale and before the closing.").

[228] N.Y.C. CHARTER & ADMIN. CODE ANN. §§ 27-2004(a)(48), 27-2005(d) (N.Y. Legal Publishing Corp. 1993 & Supp. 2011); N.Y. REAL PROP. LAW § 235-d (McKinney 2006) ("[I]t shall be unlawful . . . for any landlord . . . to engage in . . . interruption or discontinuance or willful failure to restore services . . . if such conduct is intended to cause the tenant . . . to vacate."); *see also* N.Y. PENAL LAW § 241.05 (McKinney 2008) ("An owner is guilty of harassment of a rent regulated tenant when with intent to cause a rent regulated tenant to vacate a housing accommodation, such owner . . . intent[ionally] . . . [or r]ecklessly causes physical injury to such tenant or to a third person. Harassment of a rent regulated tenant is a class E felony.").

"improve[the] tenant base"[229] of affordable housing by aggressively pursuing turnover should have raised red flags to lenders.[230] There is also ample evidence that, aided by stubborn residential segregation and redlining, the current foreclosure crisis has disproportionately affected minority homeowners.[231] Banks should also be held to account for the effects of similar discrimination against renters in communities of color.

Legislatures have consistently adopted tenant-protectionist views in response to the threat of predatory equity,[232] and courts should follow suit. Despite there being no clear statutory authority, a court may use its equitable power to order the lender to pay for repairs where the lender's negligence or recklessness in making a loan based on unrealistic expectations of high turnover resulted in improper pressure on the mortgagor to harass or coerce tenants into leaving by withholding repairs or services.[233] That many banks received credit on their Community

---

[229] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1 (quoting *Portfolio*, MILBANK, http://www.milbankre.com/portfolio.php (last visited Feb. 20, 2012) ("Milbank identified [its Bronx] assets as having added value for its investors and that revitalization would occur by infusing the capital necessary to improve the condition of the buildings, as well as aggressively pursuing the collection of past-due rents—allowing for an improved tenant base.")).

[230] *See* ASS'N FOR NEIGHBORHOOD & HOUS. DEV., *supra* note 85, at 22–25.

[231] City Council Amicus Brief, *supra* note 19, at 4; Steil, *supra* note 80, at 76–86; Dunn, *supra* note 80. *But see* EDWARD L. GLAESER & JACOB VIGDOR, MANHATTAN INST. FOR POLICY RESEARCH, THE END OF THE SEGREGATED CENTURY 3–7 (2012) (arguing that U.S. cities are today more racially integrated than at any time since 1910). Plaintiffs have sued banks such as Wells Fargo (the trustee in *Milbank*) for discriminatory lending practices. Steil, *supra* note 80, at 85 n.73 (describing suit alleging bank targeted African-Americans for subprime loans by classifying applicants by race in the bank's internal mortgage application software).

[232] *See, e.g.*, City Council Amicus Brief, *supra* note 19, at 10 (describing rationale behind the Tenant Harassment Act, N.Y.C. CHARTER & ADMIN. CODE ANN. §§ 27-2004(a)(48), 27-2005(d) (N.Y. Legal Publishing Corp. 1993)).

[233] Katherine M. Lehe, Comment, *Cracks in the Foundation of Federal Law: Ameliorating the Ongoing Mortgage Foreclosure Crisis Through Broader Predatory Lending Relief and Deterrence*, 98 CALIF. L. REV. 2049,

Reinvestment Act exams for making these oversized loans in low- and moderate-income census tracts makes an accounting all the more compelling.[234] When a court has no other tool to adequately address wrongful conduct, it may use its equitable powers to reach a fair result.

2. When the Plaintiff Isn't the Original Lender

The "reckless lender" argument is somewhat less persuasive where the mortgage note has been bought and sold several times, and the plaintiff in the foreclosure action did not originate the loan.[235] Indeed, the Uniform Commercial Code, which governs the sale of promissory notes associated with mortgages, insulates a "holder in due course" from preexisting property claims, unless the purchaser had actual knowledge of the prior claim.[236] At first blush, the "holder in due course" doctrine

---

2069–84 (2010). The new federal Consumer Finance Protection Bureau also has wide authority to regulate consumer mortgage lending, and could presumably add protections against predatory equity, but it is not clear that it will do so. *See* Kerri Panchuk, *CFPB Outlines Mortgage Servicing Regulation Strategy*, HOUSINGWIRE (Oct. 13, 2011), http://www.housingwire.com/2011/10/13/cfpb-outlines-mortgage-servicing-regulation-strategy; *see also* David Reiss, *Message in a Mortgage*, 31 B.U. REV. BANKING & FIN. L. (forthcoming 2012), *available at* http://ssrn.com/abstract=2018940.

[234] UNIV. NEIGHBORHOOD HOUS. PROGRAM, NEW YORK CITY'S MULTIFAMILY HOUSING IN DISTRESS 29 (2011), *available at* http://www.unhp.org/pdf/MultifamilyDistress.pdf.

[235] Union Sav. Bank v. 285 Lafayette Assocs., *supra* note 15.

[236] N.Y. U.C.C. LAW §§ 9-109(a)(3), 9-109 cmt. 7 (McKinney 2002) ("The security interest in the promissory note is covered by this Article even though the note is secured by a real-property mortgage."). Article 9 "does not determine the circumstances under which and the extent to which a person who is obligated on a negotiable instrument is disabled from asserting claims and defenses. Rather, Article 3 must be consulted. *See, e.g.*, Sections 3-305, 3-306." § 9-403 cmt. 2. New York's U.C.C. Article 3, Section 3-304(7) provides that "to constitute notice of a claim or defense, the purchaser must have knowledge of the claim or defense or knowledge of such facts that his action in taking an instrument amounts to bad faith." N.Y. U.C.C. LAW § 3-304(7) (McKinney 2001). The subsequent purchaser of a mortgage note, as a "holder in due course," takes it free and clear of claims to the note, unless it has actual notice of the claims. *In re* AppOnline.com, Inc., 285

would seem to absolve many subsequent holders of mortgage notes, including investment trusts holding mortgage-backed securities, from preexisting claims relating to the mortgage, such as claims that the loan originator engaged in predatory lending.[237] But neither Article 3, which contains the "holder in due course" bar, nor Article 9, which governs the sale of promissory notes, speaks to claims by third parties, unrelated to ownership of the note, and arising *after* the interest in the mortgage and note changes hands.[238] Breaches of the warranty of habitability and violations of the Housing Maintenance Code are often continuous, ongoing breaches and violations.[239] Thus, a mortgagee's "holder in due course" status should not bar this kind of relief. Still, without something more, the equities may not favor liability for a seemingly blameless successor mortgagee before it obtains a judgment of foreclosure.[240]

B.R. 805, 819 (Bankr. E.D.N.Y. 2002) (interpreting New York law), *aff'd*, 321 B.R. 614 (E.D.N.Y. 2003), *aff'd*, 128 F. App'x 171 (2d Cir. 2004). Further, the purchaser's rights are not "affected by constructive notice, unless it clearly appear[s] that the inquiry suggested by the facts disclosed at the time of the purchase would[,] if fairly pursued[,] result in the discovery of the defect existing but hidden at the time." Mfrs. & Traders Trust Co. v. Sapowitch, 72 N.E.2d 166, 169 (N.Y. 1947) (quoting Birdsall v. Russell, 29 N.Y. 220, 250 (1864) (Wright, J.)) (internal quotation marks omitted). New York is the only state that has not adopted the revised Article 3. PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, APPLICATION OF THE UNIFORM COMMERCIAL CODE TO SELECTED ISSUES RELATING TO MORTGAGE NOTES 2 n.6 (2011), *available at* http://ali.org/00021333/PEB%20Report%20-%20November%202011.pdf.

[237] Lehe, *supra* note 233, at 2066 ("[M]any borrowers who seek to challenge their mortgage loans as predatory find that the 'holder in due course' doctrine bars suit against the assignee who currently holds the mortgage note, and assignment of the mortgage precludes them from bringing suit against the mortgage originator.").

[238] *See* U.C.C. §§ 3-304(7), 9-403; *see also* Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 607–35 (2002) (recommending eliminating the holder in due course doctrine for all noncommercial loans).

[239] Bartley v. Walentas, 434 N.Y.S.2d 379, 383 (App. Div. 1980).

[240] Union Sav. Bank v. 285 Lafayette Assocs., *supra* note 15, at 21; *cf.* N.Y. REAL PROP. ACTS. LAW § 1307 (McKinney 2009) (imposing postjudgment duty to maintain premises on foreclosing mortgagee).

The *Milbank* decision sheds light on this thorny issue. The court, relying on *Fourth Federal*, only considered whether the party who sought the receiver was aware of the receiver's likely deficit. It did not ask whether the Comm trust knew about the buildings' finances when it acquired the mortgage note.[241] Given this appellate authority, a New York foreclosure court deciding a similar claim need not quibble about the precise identity of the plaintiff.[242] It might be more difficult to impose liability on the trust as opposed to the original lender, but this did not prevent the *Milbank* court from doing so.[243] The trust became liable when it asked the foreclosure court to appoint a receiver yet failed to investigate and disclose the precarious financial situation the receiver would inherit.[244] However, the court is still likely to look for some other reason to support finding the subsequent purchaser of a mortgage note liable for damages that are several steps removed from its own actions.

In some ways, the plaintiff can nearly always be linked back to the original lender. In *Milbank*, the plaintiff was not the original lender—the original mortgage lender was Deutsche Bank.[245] Deutsche Bank repackaged the mortgage note into a huge mortgage-backed securities trust, which it sold to investors.[246] While there was a lack of one-to-one identity, the demand for mortgages to back such securities was a driving

---

[241] Milbank Transcript, *supra* note 3, at 18.

[242] *See* Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 590 (App. Div. 1997).

[243] *Milbank*, No. 380454/09 (N.Y. Sup. Ct. Bronx Cnty. Sept. 29, 2010) (granting motion "for reasons stated on the record"); Milbank Transcript, *supra* note 3, at 18–19. Although the plaintiff in *Milbank* argued it should not be liable because it created a special-purpose L.L.C., which took title to the mortgage note, the L.L.C. was a wholly owned subsidiary of the Comm trust, a subterfuge the *Milbank* court easily saw past. Reply Brief of Tenant-Defendants, *supra* note 168, at 2. Even though the trust was owned by investors who were not parties to the action, the trust itself was nevertheless held liable. *Id.*

[244] Reply Brief of Tenant-Defendants, *supra* note 168, at 2. *But see* LEFCOE, *supra* note 158, at 178–79 (describing difficulty of due diligence for mortgage-backed securities investors and tendency to freeload).

[245] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1.

[246] *Id.*

force behind banks' making loans with lax underwriting.[247] In this way, the beneficiaries of the Comm trust played a role in causing the outsized loan to be made (though granted, someone else may have bought the securities if they had not).[248] In this way, a link, however attenuated, can be drawn from the loan originator to the plaintiff in the foreclosure action.

Aside from identity, this also raises questions of what duties a mortgage investor (or trustee) owes to third parties when it acquires or forecloses on a mortgage.[249] The scope of inquiry required at first seems potentially huge—the ten Bronx apartment buildings in *Milbank* were only a small piece of a multibillion-dollar investment vehicle.[250] But a mortgage-backed securities holder like the Comm trust need not scrutinize the books of every single mortgagor it forecloses on for likely deficits from spending money on repairs—most of its mortgages are likely for single-family homes for which no receiver is likely to be sought.[251] If, however, the property is an occupied multiple dwelling and the mortgagee seeks a receiver, courts have found that equity calls for an inquiry.[252] The basic premise—that

---

[247] *See* Been et al., *supra* note 69, at 390 ("The ability of mortgage originators to remove mortgages from their books through securitization may have also weakened originators' incentives to carefully screen potential loans and borrowers, as they retained little exposure to the risk of the originated loans."); Demyanyk & Van Hemert, *supra* note 82, at 1872 ("[L]enders were to some extent aware of high [loan-to-value] ratios being increasingly associated with risky borrowers."); Maddaloni & Peydró, *supra* note 82, at 2124.

[248] *But see* Nelson D. Schwartz & Shaila Dewan, *Political Push Moves a Deal On Mortgages Inches Closer*, N.Y. TIMES (Jan. 24, 2012), http://www.nytimes.com/2012/01/24/business/a-deal-on-foreclosures-inches-closer.html ("Senator Sherrod Brown of Ohio said the settlement [between lenders, federal officials, and state attorneys general] as reported—its details were not fully known—was too small and would allow banks to pass on the cost of the settlement to 'middle-class Americans' whose pension funds hold soured mortgage securities.").

[249] *See* LEFCOE, *supra* note 158, at 178–79.

[250] Milbank Tenants' Memorandum of Law, *supra* note 2, at 1.

[251] *See infra* Part V.C.2.

[252] Land v. Esrig, 43 N.Y.S.2d 623, 626 (Sup. Ct. 1943) ("The plaintiff may not be heard to object when called upon to meet an ordinary obligation necessarily and obviously incidental to the relief which he himself sought,

tenants should not have to pay for housing they do not receive—is the same regardless of who holds the mortgage and note.[253] While imposing costs on a mortgagee who did not make a reckless loan is less than ideal, it would be inequitable to allow innocent tenants to continue to suffer because of a mortgagor's failure, and a receiver's inability, to comply with the Housing Maintenance Code and warranty of habitability.[254]

3. Other Equitable Concerns

Costs to the parties to the foreclosure action should not be the court's only concern. Blight has worsened during the subprime-lending crisis,[255] and the *Milbank* rule helps prevent neglected buildings from depressing neighboring property values.[256] Abandoned properties also pose risks to neighbors, since they are magnets for squatters, fires, and crime.[257] Requiring the foreclosure plaintiff to pay for upkeep *during* the proceeding is a perfect complement to state laws that aim to fight blight by requiring foreclosing lenders to maintain

---

obtained and from which he reaped benefits."). A duty of inquiry might also be considered a quid pro quo for the limited liability a mortgagee enjoys with a receiver in place. *See supra* text accompanying notes 49–52.

[253] *See* Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 590 (App. Div. 1997).

[254] City Council Amicus Brief, *supra* note 19, at 14–17; *see* Part V.D *infra* (discussing implications).

[255] *See* Meribah Knight & Bridget O'Shea, *Foreclosures Leave Pockets of Neglect and Decay*, N.Y. TIMES (Oct. 28, 2011), http://www.nytimes.com/2011/10/28/us/foreclosures-lead-to-crime-and-decay-in-abandoned-buildings.html.

[256] *See, e.g.*, City Council Amicus Brief, *supra* note 19, at 5–6; Creola Johnson, *Fight Blight: Cities Sue to Hold Lenders Responsible for the Rise in Foreclosures and Abandoned Properties*, 2008 UTAH L. REV. 1169; Charles Towe & Chad Lawley, The Contagion Effect of Neighboring Foreclosures 1 (May 2011) (unpublished manuscript), *available at* http://ssrn.com/abstract=1834805.

[257] William Harless, *In Richmond, Foreclosed Homes Breed a New Kind of Problem*, N.Y. TIMES (Nov. 13, 2011), http://www.nytimes.com/2011/11/13/us/in-richmond-foreclosed-homes-breed-a-new-kind-of-problem.html.

properties *after* obtaining a judgment,[258] and is even more effective at nipping the problem in the bud.

Not only does this rule allow the lender to prevent the value of its collateral from further deteriorating and creating blight, but it also places the cost of upkeep on the party best able to bear it.[259] Anticipating these costs, lenders can spread them among mortgagors by setting slightly higher interest rates on mortgage loans or charging small fees,[260] which efficiently places the cost where it should be—on mortgagors, as a kind of insurance.[261] While lenders may no doubt pass added costs on to mortgage consumers—and owners, in turn, to renters—the overall effect will be negligible.[262]

Finally, applying the *Milbank* equitable rule avoids relying on undesirable, resource-intensive, and often-unavailable

---

[258] *See, e.g.*, N.Y. REAL PROP. ACTS. LAW § 1307 (McKinney 2009).

[259] Most large U.S. mortgage lenders have benefited marvelously from federal bailout funds, yet they have largely refused to reduce principal balances for underwater borrowers. Neil M. Barofsky, *Where the Bank Bailout Went Wrong*, N.Y. TIMES (Mar. 29, 2011), http://www.nytimes.com/2011/03/30/opinion/30barofsky.html; *see also* Gretchen Morgenson, *The Deal Is Done, but Hold the Applause*, N.Y. TIMES (Feb. 11, 2012), http://www.nytimes.com/2012/02/12/business/mortgage-settlement-leaves-much-to-be-desired-fair-game.html.

[260] *See, e.g.*, Elizabeth Williamson & Greg Hitt, *Mortgage 'Cramdown' Plan Hits Turbulence in Senate*, WALL ST. J. (Mar. 14, 2009), http://online.wsj.com/article/SB123698730201425761.html (describing banking industry's effort to derail plan for homeowners' mortgage write-downs, saying it "would add risk to lenders, raise mortgage rates and clog courts"); *cf. Bank of America plans $5 debit card fee*, CBS NEWS (Sept. 30, 2011), http://www.cbsnews.com/stories/2011/09/29/business/main20113708.shtml (describing banks' response to federal regulation imposing additional per-transaction costs for debit card use); Eric Dash, *Banks Quietly Ramp Up Costs To Consumers*, N.Y. TIMES (Nov. 14, 2011), http://www.nytimes.com/2011/11/14/business/banks-quietly-ramp-up-consumer-fees.html (describing more subtle ways banks are responding to the same situation, after Bank of America backed down from its $5 debit card fee).

[261] Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 491 (1991) ("[T]he relatively modest costs associated with state mortgagor protection laws do suggest that mortgagor protections may indeed promote economic efficiency.").

[262] *See infra* Part V.D (discussing implications).

government intervention to make costly emergency repairs—at the expense of taxpayers—in exchange for a tax lien on the property.[263] Intervention, while sometimes available where an owner has abandoned the property, is even less desirable where a receiver controls the premises. This is because the lender requested the receiver in order to protect its security and is concerned about the condition of the building (if only for its resale value), and because the lender must pay the receiver's expenses upon judgment and usually has the assets to do so.[264]

4. Which Repairs Should Be Covered by the Rule?

If the foreclosure court orders the mortgagee to pay for repairs, it is an open question how serious a code violation must be to trigger the lender's contribution. Broken locks threaten the safety of the tenants,[265] and cascading water leaks have long been considered by New York City agencies to be a serious condition meriting intervention,[266] but it is less clear that a leaky radiator pipe in only one apartment should deserve the same attention. Painted-over peepholes are also a threat to tenants' security, but not clearly as serious as a broken front door lock. Courts must decide whether a duty to abate an infestation of rats or mice also extends to roaches and bedbugs. The N.Y.C. Department of Housing Preservation and Development (HPD) uses a letter grading system that, while flawed, offers a handy proxy for which items should be the lender's financial responsibility and which should await a new owner.[267]

---

[263] *See supra* Part III.C.

[264] *See supra* Part II.

[265] Chris Opfer, *Foreclosures Leave Apartment Buildings in Need of Repair*, GOTHAM GAZETTE (Sept. 2011), http://www.gothamgazette.com/article/housing/20110915/10/3603.

[266] Press Release, Dep't of Hous. Pres. & Dev., HPD Commissioner Cestero and Speaker Quinn Release Findings on First Round of Extensive Inspections at Milbank Buildings (Nov. 18, 2010), *available at* http://www.nyc.gov/html/hpd/html/pr2010/pr-10-19-10.shtml.

[267] Indeed, the definitions of B and C violations track the language of the state statute requiring receivers to prioritize correction of dangerous violations, reflecting a judgment of the legislature that some repairs are more

The letter grading system uses grades of A, B, or C, with C violations being the most serious.[268] State law provides that the receiver shall give priority to the correction of "immediately hazardous and hazardous violations" of the code, which correspond to class "B" and "C" violations.[269] Not all violations (especially "A" violations) constitute a breach of the warranty of habitability.[270] Funds spent to correct "B" and "C" violations are therefore most likely to be judicious expenditures, and this should be a reliable cutoff for receivers and lenders when measuring compliance with their legal duties.

C. Applications of the Milbank *Rule*

While HPD's violations definitions provide a bright-line rule, the *Milbank* rule itself does not, and the rule's applications are not always so clear-cut. The trial court in *Milbank* extended an equity rule contemplated by the appellate court in *Fourth Federal*, without any certain appellate authority.[271] At least one other trial court, in *National Bank v. 5th Avenue Group*, has followed suit.[272] In late 2009, the owner of a small apartment

---

urgent than others. N.Y. REAL PROP. ACTS. LAW § 1325(3)(b) (McKinney 2009).

[268] *HPD Online Glossary*, *supra* note 163 ("The law establishes three classes of violations which are: 'A', non-hazardous; 'B', hazardous; or 'C', immediately hazardous.").

[269] *Id.*

[270] Park W. Mgmt. Corp. v. Mitchell, 391 N.E.2d 1288, 1294 (N.Y. 1979) ("Housing codes do not provide a complete delineation of the landlord's obligation, but rather serve as a starting point in that determination by establishing minimal standards that all housing must meet." (citing Boston Hous. Auth. v. Hemingway, 293 N.E.2d 831, 844 n.16 (Mass. 1973))). New York also requires HPD to promulgate a list of which violations are "rent-impairing," or serve as the basis for rent abatement or a defense to a suit for the nonpayment of rent. N.Y. MULT. DWELL. LAW § 302-a (McKinney 2001).

[271] Milbank Transcript, *supra* note 3, at 18–19 ("[E]ven though there's no authority before and it's not been done before perhaps except in that one case you cite . . . .").

[272] Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Dec. 20, 2011).

building in Brooklyn stopped paying its mortgage, and the bank began to foreclose on the building.[273] Intermittent heat and hot water, roof leaks, and an unsecured front door plagued the six tenants, many of whom were elderly or disabled.[274] One year later, the court appointed a receiver to collect rents and maintain the property, but the receiver could not spend more than $2,000 at a time without the bank's consent.[275] The receiver hired workers to fix the roof, but the leaks continued.[276] In May 2011, the tenants asked the foreclosure court for relief.[277] By September, their motion still pending, the building's front door remained unsecured, its locks broken.[278] Worse, the property seemed doomed from the start: its income was not nearly enough to service the $1.85 million mortgage.[279] In December 2011, the court granted the tenants' motion in full, directing the plaintiff mortgagee to advance funds to the receiver to cover the cost of emergency repairs, reasoning that, "it would be equitable for plaintiff to be required to advance funds to the Receiver where rental income is insufficient for the Receiver to fulfill his

---

[273] Opfer, *supra* note 265.

[274] *Id.*

[275] *Id.*

[276] *Id.*

[277] *Id.*

[278] *Id.* ("'That's always been a problem. They fix it and then all of a sudden it's damaged again,' said Raymond Jimenez, a retired butcher who has lived in his fourth floor apartment for 48 years.").

[279] For example, a thirty-year fixed-rate mortgage at 5.5% interest, (a conservative estimate), would have required monthly rental income of $30,500 to sustain the mortgage payments. Affidavit of Heather Gershen at paras. 8–9, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Nov. 16, 2009). The six rent-regulated tenants paid a combined $1,577 per month. Brief of Tenant-Defendants at paras. 3–4, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Nov. 16, 2009). The building contains one other residential unit and two commercial units that pay market rents, with a maximum total rent roll of $8,463 per month, nowhere close to thirty thousand dollars. *Id.* at para. 5. In order to get the loan, the owner cross-collateralized its interest in the neighboring building, which itself had a $1.95 million mortgage. Reply Affirmation at para. 3, Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Nov. 16, 2009).

duty to repair and maintain the premises."[280] Nor, as the court explained, was this designed to be a windfall to the tenants or the receiver: "assuming the building is not 'overleveraged,' . . . plaintiff will be made whole upon the sale of the property."[281] While trial courts seem to be receptive to extending the *Milbank* rule, the following examples demonstrate that, in some situations, application of the rule is not so straightforward.

1. Bedbugs

Whether the lender should pay for extermination of an apartment building with six units where the tenants complain of a building-wide bedbug[282] infestation will depend on the degree of the necessity of the expenditures. Bedbugs are currently classified as a "B" violation of the Housing Maintenance Code;[283] therefore, the lender could be found responsible for paying for the extermination, since it is the receiver's duty to correct "hazardous" conditions.[284] But there could also be a hidden causal factor if one of the tenants brought the bedbugs in, in which case it is less clear that the mortgagee should be responsible. Although exterminating bedbugs might have little impact on the building's long-term value, an infestation impacts the habitability of the units for the current tenants and affects the building's current income if units cannot be rented. Provided the "judicious expense" prong of the *Milbank* test is met, an equitable remedy seems appropriate.

2. Single-Family Rental Homes

Unlike in a multiple dwelling, a tenant of a one-family home in foreclosure faces an uphill battle to benefit from *Milbank*,

---

[280] Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Dec. 20, 2011).

[281] *Id.*

[282] *See Bed Bugs*, HPD, http://www.nyc.gov/html/hpd/html/tenants/Bed-Bugs.shtml (last visited Dec. 1, 2011).

[283] *See Sample Notice of Violation*, HPD, http://www.nyc.gov/html/hpd/downloads/pdf/bed-bugs-sample1.pdf (last visited Feb. 20, 2012).

[284] N.Y. REAL PROP. ACTS. LAW § 1325 (McKinney 2009).

because it would require extending the law with no clear precedent (since the case law discussed so far deals only with multiple dwellings).[285] Tenants of single-family homes *are* protected by the warranty of habitability,[286] a foreclosing mortgagee must maintain the premises *after* judgment,[287] and there is still a gap period between default and judgment. But the principal problem is that receivers are rarely sought for single-family homes, and thus there is no statutory support (RPAPL section 1325) for an equitable determination.[288] The mortgagee does risk becoming directly liable as a "mortgagee in possession" if it takes steps to repair the property or collect rent without a receiver in place, but mortgagees understandably steer clear of these liabilities.[289] While the tenant might not be able to obtain immediate relief against the bankrupt owner in a separate action, that avenue is available.[290] In the end, the amounts involved are likely smaller than in a multiple dwelling, making self-help more feasible.[291] The tenant can then sue the owner and wait in line along with the owner's other creditors,[292] or attempt to further extend the *Milbank* rule.

3. Where No Receiver Is Appointed

In buildings with fewer than six units, the mortgagee plaintiff often forgoes seeking a receiver.[293] Arguably, the *Fourth*

---

[285] *But see* Lirosi v. Elkins, 453 N.Y.S.2d 718, 723 (App. Div. 1982) ("[A] court of equity is not precluded from fashioning a suitable remedy, although precedent is wanting.").

[286] REAL PROP. ACTS. § 235-b; Birch v. Ryan, 721 N.Y.S.2d 711, 711–12 (App. Div. 2001).

[287] REAL PROP. ACTS. § 1307.

[288] *See* Rasmussen, *supra* note 16.

[289] Mortimer v. E. Side Sav. Bank, 295 N.Y.S. 695, 698 (App. Div. 1937); Rasmussen, *supra* note 16.

[290] *See supra* Part III.D.

[291] *See supra* Part III.D.

[292] *See supra* Part III.D.

[293] Rasmussen, *supra* note 16 ("Receivers . . . are not usually appointed to care for the small buildings that are the subject of the vast majority of foreclosure actions now.").

Federal equitable inquiry is irrelevant in a case where there is no receiver, the mortgagor is still in possession, or where the mortgagee comes into possession. While legislatures increasingly pass laws to protect tenants at foreclosure, at the same time there is a desire to avoid fees and costs to small owners who actually live in their buildings.[294] Moreover, the tenants of a small building may find it less likely for a live-in owner to skip town (or skimp on repairs) and easier to compel the owner to make repairs in an HP action.[295]

4. Affordable Loans and Not-for-Profit Lenders

While *Milbank* held a mortgagee accountable for a loan that should possibly never have been made, its application to a lender who made an affordable loan or to a not-for-profit lender is more problematic because no "predatory equity" angle is present and the lender likely has fewer assets at its disposal. *Milbank*'s four-part equitable test does not necessarily speak to this one way or the other. The court's analysis focused on whether the foreclosing mortgage lender had been aware that the building's income would be insufficient to pay the receiver's expenses when it asked that the court appoint a receiver.[296] Application of the test would still result in a mortgagee's responsibility to pay for repairs, even though it made an affordable loan, if the receiver's anticipated expenses were more than the anticipated income when the plaintiff sought to have a receiver appointed.[297] Nonprofits may have less capital to finance interim upkeep, but they would still be liable for postjudgment upkeep under the statute, which does not exempt them.[298]

---

[294] *Hearings*, *supra* note 1, at 164–65 (testimony of Elizabeth M. Lynch, MFY Legal Servs.); E-mail from Brad Lander, N.Y.C. Councilmember, to author (Nov. 13, 2011, 8:51 AM EST) (on file with author).

[295] In an HP action, the tenant sues the owner and the Department of Housing Preservation and Development seeking repairs to correct outstanding violations. *See supra* Part III.D.

[296] Fourth Fed. Sav. Bank v. 32-22 Owners Corp., 653 N.Y.S.2d 588, 590 (App. Div. 1997).

[297] *Id.*

[298] *See* N.Y. REAL PROP. ACTS. LAW § 1307 (McKinney 2009).

Alternatively, if the law were to require the lender to post a compliance bond, it may not bear such a heavy financial burden.[299] In sum, despite its difficult application, the *Milbank* rule is workable and malleable enough to make it a viable option for tenants who have difficulty seeking repairs from owners in foreclosure.

D. Implications of Extending Milbank

There are a few problematic implications of extending the *Milbank* rule, such as increased costs to borrowers, disincentives for foreclosure plaintiffs to seek receivers, and the propriety of extending a liability rule in response to a crisis, since conditions that currently justify reform may no longer exist in the future. Taken together, however, the positive outcomes that would result from wider application of the *Milbank* rule significantly outweigh these consequences.

Banks may assert that the rule will decrease mortgage lending, or make it more costly to lend to people at the margins.[300] But Milbank was an exceptional case in that most buildings in foreclosure will not require millions of dollars in additional funds to correct hazardous conditions.[301] Banks have shown that they can survive new regulatory requirements that have significantly hurt their bottom line. For example, the cost of compliance with new interchange fees for debit card purchases will run into the billions, yet banks are finding small-bore ways of recouping these losses.[302] In the context of mortgage lending, where fees are already substantial and rising, the net effect on consumers of a small market-wide increase due

---

[299] *See infra* Part VI.

[300] *See, e.g.*, Williamson & Hitt, *supra* note 260.

[301] *See* Nat'l Bank of N.Y.C. v. 296 5th Ave. Grp., No. 29057/09 (N.Y. Sup. Ct. Kings Cnty. Dec. 20, 2011) (ordering plaintiff to advance funds to receiver for repairs estimated to cost $65,150); City Council Amicus Brief, *supra* note 19, at 7 ("In fiscal year 2011, HPD budgeted over $29 million for emergency repairs [citywide].").

[302] *See Bank of America plans $5 debit card fee*, *supra* note 260; Dash, *supra* note 260.

to the *Milbank* rule is probably minimal.[303] From a public policy perspective, spreading the cost of remediating poor housing conditions across all mortgage borrowers is desirable because it more effectively and more efficiently minimizes the risk of harm to more people.[304] In addition, slightly increasing the costs of borrowing may deliver better incentives to consumers deciding whether to rent or buy.[305] Federal housing policy has placed too strong an emphasis on homeownership, and many people who were able to qualify for loans in 2006 would have been better off renting instead.[306] At bottom, however, extending *Milbank* will probably increase costs to borrowers, but not by any appreciable amount.[307] It is also possible that extension of the

---

[303] *See* Amy Hoak, *Beware: Mortgage Fees Are Rising*, WALL ST. J. (Feb. 26, 2012), http://online.wsj.com/article/SB10001424052970203918304577239470865575682.html.

[304] *See* Schill, *supra* note 261, at 491; *cf.* Gretchen Morgenson, *Hazard Insurance with Its Own Perils*, N.Y. TIMES (Jan. 22, 2012), http://www.nytimes. com/2012/01/22/business/hazard-insurance-with-its-own-perils-fair-game.html ("[Instead of forced-place insurance, a] more consumer-friendly way to deal with insurance lapses would be for [mortgage] servicers to advance money to the borrower's existing [insurance] carrier to keep the policy current. Then, the servicer could bill the borrower for the coverage.").

[305] *See* Kevin Quealy & Archie Tse, *Is It Better to Buy or Rent?*, N.Y. TIMES, http://www.nytimes.com/interactive/business/buy-rent-calculator.html (last visited Mar. 12, 2012) (featuring an interactive tool weighing relative costs of renting versus buying).

[306] *See generally* Arlo Chase, *Rethinking the Homeownership Society: Rental Stability Alternative*, 18 J.L. & POL'Y 61 (2010) (arguing for a policy shift away from homeownership and toward protecting renters through a modified rent-regulation scheme); *see also* EDWARD L. GLAESER, TRIUMPH OF THE CITY 264 (2011) ("The home interest mortgage deduction . . . encourages Americans to leverage themselves to the hilt to bet on housing . . . . Subsidizing home ownership actually pushes up housing prices by encouraging people to spend more."); CHARLES R. MORRIS, THE TRILLION DOLLAR MELTDOWN 69 (2008) (coining the term "NINJA loan," which stands for No Income, No Job or Assets, meaning loans made without requiring proof of those typical signs of creditworthiness).

[307] *See* Gilberto Fuentes, *What Causes Mortgage Borrowing Costs to Increase?*, SF GATE, http://homeguides.sfgate.com/causes-mortgage-borrowing-costs-increase-8921.html (last visited Feb. 20, 2012) (identifying inflation, money supply, and broader economic conditions as the main factors driving costs of mortgage borrowing).

rule may increase rents for tenants; but, again, the overall effect is probably negligible.[308]

Aside from mere cost, the plaintiff in *Milbank* argued that extending liability to it would mean that foreclosure plaintiffs would no longer be willing to seek receivers.[309] But mortgagees will still desire to have the limitation on liability that comes with the appointment of a receiver, which is unavailable to them as mortgagees-in-possession.[310] Because of the favorable limitations on liability, applying *Milbank* more broadly is unlikely to affect the decision whether or not to seek the appointment of a receiver.[311] Mortgagees will still need to protect their security from deterioration in order to recoup as much as possible from the foreclosure sale. If the building needs repair, this is practically impossible to accomplish without either having a receiver or becoming a mortgagee-in-possession.[312] Diverting a building's rental income from the owner and investing it back into the building also makes sound business sense because it maximizes the value of the loan's collateral.[313] This suggests that mortgagees would still seek receivers just as often.

---

[308] *See* Paula Beck, *Fighting Section 8 Discrimination: The Fair Housing Act's New Frontier*, 31 HARV. C.R.-C.L. L. REV. 155, 180 (1996) (explaining how landlords might react to an influx of subsidized tenants by spreading the cost across their subsidized and unsubsidized holdings). Costs of financing are only one component of what the N.Y.C. Rent Guidelines Board considers when deciding on a schedule of increases for rent-stabilized apartments. *Process by Which the Rent Guidelines Board Determines the Guidelines*, N.Y.C. RENT GUIDELINES BD., http://www.housingnyc.com/html/guidelines/guidelines.html (last visited Feb. 20, 2012) ("These include: the economic condition of the residential real estate industry in N.Y.C. including such factors as the prevailing and projected (i) real estate taxes and sewer and water rates, (ii) gross operating maintenance costs (including insurance rates, governmental fees, cost of fuel and labor costs), (iii) costs and availability of financing (including effective rates of interest), [and] (iv) over-all supply of housing accommodations and over-all vacancy rates.").

[309] Wheeler Affidavit, *supra* note 157, at para. 4.

[310] *See* Bankers Fed. Sav. Bank FSB v. Off West Broadway Developers, 638 N.Y.S.2d 72, 74 (App. Div. 1996).

[311] Herz et al., *supra* note 26, at 38.

[312] Mortimer v. E. Side Sav. Bank, 295 N.Y.S. 695, 698 (App. Div. 1937).

[313] Herz et al., *supra* note 26, at 38.

Even if mortgagees are able to bear or distribute the additional costs, and still seek receivers, extending a rule of law during a financial crisis raises concerns about the rule's applicability after the crisis. Although the current situation seems unprecedented,[314] dangers to tenants at foreclosure are a cyclical, recurring problem.[315] The warranty of habitability and housing code also do not typically change from boom to bust—the duty that foreclosing lenders owe to tenants should remain constant as well. Those tenants who pay rent are *innocent* victims of a foreclosure, crisis or not.[316]

In sum, New York[317] courts should extend *Milbank* to apply more broadly where the receivership suffers a foreseeable deficit, the expenses are necessary and judicious, and there will be some benefit to the mortgagee. In addition, some courts may insist on some level of culpability by the current mortgagee if it is not the original lender. Extension of the rule will help protect innocent renters who, by no fault of their own, suffer adverse consequences from their landlords' defaults.

VI. STATUTORY REMEDIES FOR TENANTS IN FORECLOSURE ACTIONS SHOULD ALSO BE EXPANDED

Extending the *Milbank* rule is a vital part of a robust judicial response to the foreclosure crisis, but legislatures also have a role to play. Because the options available to tenants in such situations (including the equitable remedy in *Milbank*) are few, narrow, and uncertain, state legislatures should adopt laws

---

[314] *See supra* Part III.

[315] Rasmussen, *supra* note 22.

[316] *See* Been & Glashausser, *supra* note 17, at 3.

[317] In other states, tenant advocates and foreclosure courts should consider whether equitable relief is available where the equitable factors from *Milbank* are present. If, for instance, a Massachusetts building in foreclosure is afflicted with a substantial Sanitary Code violation, under what circumstances may the tenant compel the out-of-possession mortgagee to pay for repairs before a judgment is entered? *See* MASS. GEN. LAWS ch. 111, § 127A (2002); Berman & Sons, Inc. v. Jefferson, 396 N.E.2d 981, 982–84 (Mass. 1979). After all, the tenant is entitled to stay absent good cause for eviction. *See supra* Part III. This entitlement would serve little purpose if the tenant were constructively evicted.

formalizing a duty on the part of foreclosing mortgagees to maintain the premises during the foreclosure action. This would, importantly, close any loophole a lender might exploit by declining to seek the appointment of a receiver it would otherwise seek,[318] or by starting the foreclosure action through a mortgage servicer who is not technically the mortgagee.[319] Codifying a legal duty would make it straightforward for tenants to seek needed repairs in an action against the mortgagee,[320] and it would allow courts to skip the messy and searching inquiry into whether the lender knew the receiver's income would be inadequate.[321] Tenants caught in gap situations would be able to seek relief without extensive motion practice.[322] Ideally, a legal duty on the books would be prophylactic and simply cause foreclosing mortgagees to begin to fund necessary repairs as soon as a receiver is appointed.[323] But realistically, reform at the state level may be far off.

In addition to the duty requirement, state legislatures should create compliance-bond-posting requirements for mortgagees who seek to foreclose on multiple dwellings. Such laws would require the mortgagee to post a bond to cover anticipated costs associated with compliance with the applicable housing code and warranty of habitability at the start of the foreclosure action.[324]

---

[318] Brief of Comm 2006-C8, *supra* note 166, at 7.

[319] *Hearings*, *supra* note 1, at 164–65 (testimony of Elizabeth M. Lynch, MFY Legal Servs.). If the mortgage servicer is not an assignee, the mortgagee may also be a necessary party to the foreclosure action. *See* J.V. Dempsey, *Mortgagee or Lienholder as a Proper or Necessary Party to Suit in Respect of Contract for Sale of Mortgaged Property*, 164 A.L.R. 1044 (2011).

[320] For example, the statute might authorize New York City tenants to bring an HP action against the lender in Housing Court. *See supra* Part III.D.

[321] *See supra* Part IV.B.3. A legal duty enacted at the state level would obviate the need for *Milbank*'s four-factor equitable test in order to compel a prejudgment advance from the mortgagee to the receiver.

[322] *Cf. supra* Part III.D (describing the non-availability of relief in Housing Court against a receiver in particular and against the owner in foreclosure generally).

[323] Brief of Comm 2006-C8, *supra* note 166, at 2–3 (describing funds already advanced to receiver).

[324] *See, e.g.*, Intro. 494, 2011 Leg., 2011 Sess. (N.Y.C. Council 2011),

Importantly, this would lessen the burden on mortgagees, especially smaller ones, and help stabilize costs.

There are currently two proposals before the New York City Council to enact local laws further strengthening protections for tenants at foreclosure.[325] Intro 0494-2011 would require mortgagees who seek foreclosure to secure and maintain a compliance bond, which would be used to cover the cost of compliance with the Housing Maintenance Code.[326] Intro 0500-2011 would establish a duty requiring a foreclosing mortgagee to maintain the property during the pendency of the foreclosure action.[327] Yet unresolved is whether any city law affecting foreclosures or nationally chartered banks will, as the bill opponents claim, be preempted by state or federal law.[328] Both bills have been laid over in committee after a hearing,[329] and one of the bills' sponsors reports that the committee is working to address the preemption issues and to add a carve-out for smaller, owner-occupied multiple dwellings.[330]

---

available at http://legistar.council.nyc.gov/ViewReport.ashx?M=R&N=Text&GID=61&ID=876270&GUID=9F704201-DB6B-469D-B3F4-6201F52041A1&Title=Legislation+Text (proposing to amend N.Y.C. ADMIN. CODE tit. 27, ch. 2 by adding § 27-2109.1).

[325] The City Council passed Intro 501-2011 into law on February 16, 2012, requiring foreclosing mortgagees to notify HPD. Intro. 501, 2011 Leg., 2011 Sess. (N.Y.C. Council 2011), http://legistar.council.nyc.gov/ViewReport.ashx?M=R&N=Text&GID=61&ID=1079568&GUID=0487EFDD-CBF5-4F0E-B66E-4E6A9DFD2A47&Title=Legislation+Text (amending the N.Y.C. ADMIN. CODE tit. 27 by adding § 27-2109.1). While a notification requirement is a great start, it does not directly address the plight of tenants facing poor housing conditions, especially if one considers that HPD may already know about most problem buildings because of the number of tenant complaints and violations.

[326] Intro. 494.

[327] Intro. 500, 2011 Leg., 2011 Sess. (N.Y.C. Council 2011), http://legistar.council.nyc.gov/ViewReport.ashx?M=R&N=Text&GID=61&ID=883506&GUID=EECABA30-EF8D-4B74-ACCE-E66435CE18C1&Title=Legislation+Text (proposing to amend the N.Y.C. ADMIN. CODE).

[328] *See* Cuomo v. Clearing House Ass'n, L.L.C., 129 S. Ct. 2710, 2721 (2009) (holding that state regulatory agency could not enforce regulation with respect to nationally-chartered banks); *Hearings*, *supra* note 1, at 85 (testimony of Michael P. Smith).

[329] Intro. 494; Intro. 500.

[330] E-mail from Brad Lander, *supra* note 294; *Hearings*, *supra* note 1, at

Even if the mayor signs these measures into law, worrisome concerns remain about state- or federal-law preemption of a local law affecting the foreclosure process or regulating nationally chartered banks.[331] Passing new tenant protections at the state level would alleviate any concern about state-law preemption.[332] Likewise, passing bank regulation at the federal level could mollify any concern about federal-law preemption.[333] But these are much more daunting challenges than attempts to pass local legislation.[334] Even though it is unlikely to pass at the state or federal level, advocates should continue to push for positive reform, since current statutory schemes are inadequate to protect tenants,[335] and an equitable remedy against a lender will only aid those who can show that the mortgagee was aware of a likely deficit when it asked for the receiver.[336] A statutory solution would contribute greatly to protecting tenants.

VII. CONCLUSION

Extending *Milbank* will help protect tenants of multiple dwellings during the gap period between a mortgagor's initial default and a final judgment awarding possession to the

---

165 (testimony of Elizabeth M. Lynch) ("In our experience, homeowners . . . in one- to four-family houses, rarely abandon their houses. They usually maintain the property and try to work with the bank to get a modification.").

[331] Stoffer v. Dep't of Pub. Safety of Huntington, 907 N.Y.S.2d 38, 45 (App. Div. 2010) ("Where the Legislature has not expressly forbidden local governments from superseding state law, a local government may nevertheless be prohibited from enacting superseding legislation, pursuant to the doctrine of preemption, where the State has evidenced an intent to occupy the field."); *see also Cuomo*, 129 S. Ct. at 2721; *Hearings*, *supra* note 1, at 85 (testimony of Michael P. Smith).

[332] *See Stoffer*, 907 N.Y.S.2d at 45.

[333] *See Cuomo*, 129 S. Ct. at 2721.

[334] Michael Powell & Nicholas Confessore, *Dysfunction Displaces Work in Distracted Albany*, N.Y. TIMES (Mar. 6, 2010), http://www.nytimes.com/2010/03/06/nyregion/06albany.html ("The State Senate can't get 32 votes to agree that today is Thursday." (quoting Daniel J. O'Donnell, Assemblyman, N.Y.C.) (internal quotation marks omitted)).

[335] *See supra* Part III.

[336] *See supra* Part V.

mortgagee, especially in the increasingly common scenario when the owner "walks away." By providing a source of funding for necessary repairs, the four-factor equitable test helps reinforce existing eviction-protection measures for tenants and serves as a backstop against constructive eviction, blight, and the loss of affordable housing through predatory equity. Finally, though proponents face several challenges, codifying a duty or a compliance-bond requirement will also go a long way toward realizing *Milbank*'s potential to solve this persistent problem.[337]

[337] Jim Dwyer, *The Mortgage Was Like a Shell Game; So Is Responsibility in 3 Deaths*, N.Y. TIMES (Apr. 28, 2011), http://www.nytimes.com/2011/04/29/nyregion/subprime-mortgage-in-bronx-building-where-3-died-in-fire.html.